# ANSWERS TO BAR

# EXAMINATION QUESTIONS

# IN

# TAXATION LAW

## * ARRANGED BY TOPIC *

# (1994 – 2006)

**Edited and Arranged by:**
**ROMUALDO L. SEÑERIS II**
Silliman University - College of Law

**From the ANSWERS TO BAR EXAMINATION QUESTIONS**
**by the UP LAW COMPLEX**
**&**
**PHILIPPINE ASSOCIATION OF LAW SCHOOLS**

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# FOREWARD

This work is NOT intended FOR SALE or COMMERCE. This work is a freeware. It may be freely copied and distributed, nevertheless, PERMISSION TO COPY from the editors is ADVISABLE to protect the interest of the ORIGINAL SOURCES/REFERENCES of this material…. It is primarily intended for all those who desire to have a deeper understanding of the issues commonly touched by the Philippine Bar Examinations and its trend on specifically on Taxation Laws. It is specifically intended for law students from the provinces who, very often, are recipients of deliberately distorted notes from other unscrupulous law schools and students.

I would like to seek the indulgence of the reader for some Bar Questions which are improperly classified under a topic and for some topics which are improperly or ignorantly phrased, for the arranger is just a Bar Reviewee who has prepared this work while reviewing for the 2nd time for the Bar Exams 2007 under time constraints and within his limited knowledge of the law. I would like to seek the reader's indulgence also for a number of typographical errors in this work.

The Arranger

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# GENERAL PRINCIPLES

### Basic Features: Present Income Tax System (1996)

What are the basic features of the present income tax system"?

**SUGGESTED ANSWER:**

Our present income tax system can be said to have the following basic features:

(a) It has adopted a ***COMPREHENSIVE TAX SITUS*** by using the nationality, residence, and source rules. This makes citizens and resident aliens taxable on their income derived from all sources while non-resident aliens are taxed only on their income derived from within the Philippines. Domestic corporations are also taxed on universal income while foreign corporations are taxed only on income from within.

(b) The individual income tax system is mainly ***PROGRESSIVE IN NATURE*** in that it provides a graduated rates of income tax. Corporations in general are taxed at a flat rate of thirty five percent (35%) of net income.

(c) It has retained ***MORE SCHEDULAR THAN GLOBAL FEATURES*** with respect to individual taxpayers but has maintained a more global treatment on corporations.

**Note:** *The following might also be cited by the bar candidates as features of the income tax system:*

a. Individual compensation income earners are taxed on modified Gross Income (Gross compensation income less personal exemptions). Self-employed and professionals are taxed on net income with deductions limited to seven items or in lieu thereof the forty percent (40%) maximum deduction plus the personal exemptions. Corporations are generally taxed on net income except for non-resident foreign corporations which are taxed on gross income.

b. The income tax is generally imposed via the self-assessment system or pay-as-you-file concept of imposing the tax although certain incomes. Including income of non-residents, are taxed on the pay-as-you-earn concept or the so called withholding tax.

c. The corporate income tax is a one-layer tax in that distribution of profits to stockholders *(except to non-residents)* are not subject to income tax.

### Basic Stages or Aspects of Taxation (2006)

Enumerate the 3 stages or aspects of taxation. Explain each. (5%)

**SUGGESTED ANSWER:**

The aspects of taxation are:

(1) LEVYING — the act of the legislature in choosing the persons, properties, rights or privileges to be subjected to taxation.

(2) ASSESSMENT and COLLECTION — This is the act of executing the law through the administrative agencies of government.

(3) PAYMENT — the act of the taxpayer in settling his tax obligations.

### Collection of Taxes: Authority; Ordinary Courts (2001)

May the courts enjoin the collection of revenue taxes? Explain your answer. (2%)

**SUGGESTED ANSWER:**

As a general rule, the courts have no authority to enjoin the collection of revenue taxes. (Sec. 218, NIRC). However, the Court of Tax Appeals is empowered to enjoin the collection of taxes through administrative remedies when collection could jeopardize the interest of the government or taxpayer. (Section 11, RA 1125).

### Collection of Taxes: Prescription (2001)

May the collection of taxes be barred by prescription? Explain your answer. (3%)

**SUGGESTED ANSWER:**

Yes. The collection of taxes may be barred by prescription. The prescriptive periods for collection of taxes are governed by the tax law imposing the tax. However, if the tax law does not provide for prescription, the right of the government to collect taxes becomes imprescriptible.

### Direct Tax vs. Indirect Tax (1994)

Distinguish a direct from an indirect tax.

**SUGGESTED ANSWER:**

A DIRECT TAX is one in which the taxpayer who pays the tax is directly liable therefor, that is, the burden of paying the tax falls directly on the person paying the tax.

An INDIRECT TAX is one paid by a person who is not directly liable therefor, and who may therefore shift or pass on the tax to another person or entity, which ultimately assumes the tax burden. ***(Maceda v. Macaraig, 197 SCRA 771)***

### Direct Tax vs. Indirect Tax (2000)

Among the taxes imposed by the Bureau of Internal Revenue are income tax, estate and donor's tax, value-added tax, excise tax, other percentage taxes, and documentary stamp tax. Classify these taxes into direct and indirect taxes, and differentiate direct from Indirect taxes. (5%)

**SUGGESTED ANSWER:**

Income tax, estate and donor's tax are considered as direct taxes. On the other hand, value-added tax, excise tax, other percentage taxes, and documentary stamp tax are indirect taxes.

DIRECT TAXES are demanded from the very person who, as intended, should pay the tax which he cannot shift to another; while an INDIRECT TAX is demanded in the first instance from one person with the expectation that he can shift the burden to someone else, not as a tax but as a part of the purchase price.

### Direct Tax vs. Indirect Tax (2001)

Distinguish direct taxes from indirect taxes, and give an example for each one. (2%)

**SUGGESTED ANSWER:**

DIRECT TAXES are taxes wherein both the incidence (or liability for the payment of the tax) as well as the impact or burden of the tax falls on the same person. An

example of this tax is income tax where the person subject to tax cannot shift the burden of the tax to another person.

INDIRECT TAXES, on the other hand, are taxes wherein the incidence of or the liability for the payment of the tax falls on one person but the burden thereof can be shifted or passed on to another person. Example of this tax is the value-added tax.

**ALTERNATIVE ANSWER:**
A direct tax is a tax which is demanded from the person who also shoulders the burden of the tax. Example: corporate and individual income tax.

An indirect tax is a tax which is demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another, and the burden finally resting on the ultimate purchaser or consumer. Example: value added tax.

### Direct Tax vs. Indirect Tax (2006)
Distinguish "direct taxes" from "indirect taxes." Give examples. (5%)
**SUGGESTED ANSWER:**
DIRECT TAXES are demanded from the very person who should pay the tax and which he can not shift to another. An INDIRECT TAX is demanded from one person with the expectation that he can shift the burden to someone else, not as a tax but as part of the purchase price. Examples of direct taxes are the income tax, the estate tax and the donor's tax. Examples of indirect taxes are the value-added tax, the percentage tax and the excise tax on exciseable articles.

### Double Taxation (1997)
Is double taxation a valid defense against the legality of a tax measure?
**SUGGESTED ANSWER:**
No, double taxation standing alone and not being forbidden by our fundamental law is not a valid defense against the legality of a tax measure ***(Pepsi Cola v. Tanawan, 69 SCRA 460).*** However, if double taxation amounts to a direct duplicate taxation,

1. in that the same subject is taxed twice when it should be taxed but once,
2. in a fashion that both taxes are imposed for the same purpose
3. by the same taxing authority, within the same jurisdiction or taxing district,
4. for the same taxable period and
5. for the same kind or character of a tax

then it becomes legally objectionable for being oppressive and inequitable.

### Double Taxation: What Constitutes DT? (1996)
X, a lessor of a property, pays real estate tax on the premises, a real estate dealer's tax based on rental receipts and income tax on the rentals. X claims that this is double taxation? Decide.
**SUGGESTED ANSWER:**
There is no double taxation. DOUBLE TAXATION means taxing for the same tax period the same thing or activity twice, when it should be taxed but once, by the same taxing authority for the same purpose and with the same kind or character of tax. The REAL ESTATE TAX is a tax on property; the REAL ESTATE DEALER'S TAX is a tax on the privilege to engage in business; while the INCOME TAX is a tax on the privilege to earn an income. These taxes are imposed by different taxing authorities and are essentially of different kind and character ***(Villanueva vs. City of Iloilo, 26 SCRA 578).***

### Double Taxation; Indirect Duplicate Taxation (1997)
When an item of income is taxed in the Philippines and the same income is taxed in another country, is there a case of double taxation?
**SUGGESTED ANSWER:**
Yes, but it is only a case of indirect duplicate taxation which is not legally prohibited because the taxes are imposed by different taxing authorities.

### Double Taxation; License Fee vs. Local Tax (2004)
A municipality, BB, has an ordinance which requires that all stores, restaurants, and other establishments selling liquor should pay a fixed annual fee of P20.000. Subsequently, the municipal board proposed an ordinance imposing a sales tax equivalent to 5% of the amount paid for the purchase or consumption of liquor in stores, restaurants and other establishments. The municipal mayor, CC, refused to sign the ordinance on the ground that it would constitute double taxation. Is the refusal of the mayor justified? Reason briefly. (5%)
**SUGGESTED ANSWER:**
No. The refusal of the mayor is not justified. The impositions are of different nature and character. The fixed annual fee is in the nature of a license fee imposed through the exercise of police power while the 5% tax on purchase or consumption is a local tax imposed through the exercise of taxing powers. Both a license fee and a tax may be imposed on the same business or occupation, or for selling the same article and this is not in violation of the rule against double taxation {***Campania General de Tabacos de Filipinos v. City of Manila, 8 SCRA 367 [1963]***).

### Double Taxation; Methods of Avoiding DT (1997)
What are the usual methods of avoiding the occurrence of double taxation?
**SUGGESTED ANSWER:**
The usual methods of avoiding the occurrence of double taxation are:

1. Allowing reciprocal exemption either by law or by treaty;
2. Allowance of tax credit for foreign taxes paid;
3. Allowance of deduction for foreign taxes paid; and
4. Reduction of the Philippine tax rate.

*Note: Any three of the methods shall be given full credit.*

### Imprescriptibility of Tax Laws (1997)
Taxes were generally imprescriptible; statutes, however, may provide otherwise. State the rules that have been adopted on this score by -

(a) The National Internal Revenue Code;
(b) The Tariff and Customs Code; and
(c) The Local Government Code Answer:

**SUGGESTED ANSWERS:**

The rules that have been adopted on prescription are as follows:

(a) **National Internal Revenue Code** - The statute of limitation for assessment of tax if a return is filed is within three (3) years from the last day prescribed by law for the filing of the return or if filed after the last day, within three years from date of actual filing. If no return is filed or the return filed is false or fraudulent, the period to assess is within TEN YEARS from discovery of the omission, fraud or falsity.

The period to collect the tax is within THREE YEARS from date of assessment. In the case, however, of omission to file or if the return filed is false or fraudulent, the period to collect is within TEN YEARS from discovery without need of an assessment.

(b) **Tariff and Customs Code** - It does not express any general statute of limitation; it provided, however, that "when articles have entered and passed free of duty or final adjustment of duties made, with subsequent delivery, such entry and passage free of duty or settlement of duties will, after the expiration of ONE (1) YEAR, from the date of the final payment of duties, in the absence of fraud or protest, be final and conclusive upon all parties, unless the liquidation of Import entry was merely tentative" (Sec 1603, TCC).

(c) **Local Government Code** - Local taxes, fees, or charges shall be assessed within FIVE (5) YEARS from the date they became due. In case of fraud or intent to evade the payment of taxes, fees or charges the same maybe assessed within TEN YEARS from discovery of the fraud or intent to evade payment. They shall also be collected either by administrative or judicial action within FIVE (5) YEARS from date of assessment (Sec. 194, LGC).

### Power of Taxation: Equal Protection of the Law (2000)

An Executive Order was issued pursuant to law, granting tax and duty incentives only to businesses and residents within the "secured area" of the Subic Economic Special Zone, and denying said incentives to those who live within the Zone but outside such "secured area". Is the constitutional right to equal protection of the law violated by the Executive Order? Explain. (3%)

**SUGGESTED ANSWER:**

No. Equal protection of the law clause is subject to reasonable classification. Classification, to be valid, must (1) rest on substantial distinctions, (2) be germane to the purpose of the law, (3) not be limited to existing conditions only, (4) apply equally to all members of the same class. There are substantial differences between big investors being enticed to the "secured area" and the business operators outside that are in accord with the equal protection clause that does not require territorial uniformity of laws. The classification applies equally to all the resident individuals and businesses within the "secured area". The residents, being in like circumstances to contributing directly to the achievement of the end purpose of the law, are not categorized further. Instead, they are similarly treated, both in privileges granted and obligations required. *(Tiu, et al, v. Court of 4npeals, et al, G.R. No. 127410, January 20, 1999)*

### Power of Taxation: Inherent in a Sovereign State (2003)

Why is the power to tax considered inherent in a sovereign State? (4%)

**SUGGESTED ANSWER:**

It is considered inherent in a sovereign State because it is a necessary attribute of sovereignty. *Without this power no sovereign State can exist or endure. The power to tax proceeds upon the theory that the existence of a government is a necessity and this power is an essential and inherent attribute of sovereignty, belonging as a matter of right to every independent state or government.* No sovereign state can continue to exist without the means to pay its expenses; and that for those means, it has the right to compel all citizens and property within its limits to contribute, hence, the emergence of the power to tax. *(51 Am. Jur.,Taxation 40).*

### Power of Taxation: Legality; Local Gov't Taxation (2003)

May Congress, under the 1987 Constitution, abolish the power to tax of local governments? (4%)

**SUGGESTED ANSWER:**

No. Congress cannot abolish what is expressly granted by the fundamental law. The only authority conferred to Congress is to provide the guidelines and limitations on the local government's exercise of the power to tax (Sec. 5, Art. X, 1987 Constitution).

### Power of Taxation: Legislative in Nature (1994)

The Secretary of Finance, upon recommendation of the Commissioner of Internal Revenue, issued a Revenue Regulation using gross income as the tax base for corporations doing business in the Philippines. Is the Revenue Regulation valid?

**SUGGESTED ANSWER:**

The regulation establishing gross income as the tax base for corporations doing business in the Philippines (domestic as well as resident foreign) is not valid. This is no longer implementation of the law but actually it constitutes legislation because among the powers that are exclusively within the legislative authority to tax is the power to determine -the amount of the tax. *(See 1 Cooley 176-184).* Certainly, if the tax is limited to gross income without deductions of these corporations, this is changing the amount of the tax as said amount ultimately depends on the taxable base.

### Power of Taxation: Limitations of the Congress (2001)

Congress, after much public hearing and consultations with various sectors of society, came to the conclusion that it will be good for the country to have only one

system of taxation by centralizing the imposition and collection of all taxes in the national government. Accordingly, it is thinking of passing a law that would abolish the taxing power of all local government units. In your opinion, would such a law be valid under the present Constitution? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No. The law centralizing the imposition and collection of all taxes in the national government would contravene the Constitution which mandates that: . . . "Each local government unit shall have the power to create their own sources of revenue and to levy taxes, fees, and charges subject to such guidelines and limitations as Congress may provide consistent with the basic policy of local autonomy." It is clear that Congress can only give the guidelines and limitations on the exercise by the local governments of the power to tax but what was granted by the fundamental law cannot be withdrawn by Congress.

### Power of Taxation: Limitations: Passing of Revenue Bills (1997)

The House of Representatives introduced HB 7000 which envisioned to levy a tax on various transactions. After the bill was approved by the House, the bill was sent to the Senate as so required by the Constitution. In the upper house, instead of a deliberation on the House Bill, the Senate introduced SB 8000 which was its own version of the same tax. The Senate deliberated on this Senate Bill and approved the same. The House Bill and the Senate Bill were then consolidated in the Bicameral Committee. Eventually, the consolidated bill was approved and sent to the President who signed the same. The private sectors affected by the new law questioned the validity of the enactment on the ground that the constitutional provision requiring that all revenue bills should originate from the House of Representatives had been violated. Resolve the issue.

**SUGGESTED ANSWER:**

There is no violation of the constitutional requirement that all revenue bills should originate from the House of Representatives. What is prohibited is for the Senate to enact revenue measures on its own without a bill originating from the House. But once the revenue bill was passed by the House and sent to the Senate, the latter can pass its own version on the same subject matter consonant with the latter's power to propose or concur with amendments. This follows from the co-equality of the two chambers of Congress (***Tolentino v. Secretary of Finance, GR No. 115455, Oct. 30, 1995***).

### Power of Taxation: Limitations; Power to Destroy (2000)

Justice Holmes once said: *The power to tax is not the power to destroy while this Court (the Supreme Court) sits."* Describe the power to tax and its limitations. (5%)

**SUGGESTED ANSWER:**

The power to tax is an inherent power of the sovereign which is exercised through the legislature, to impose burdens upon subjects and objects within its Jurisdiction for the purpose of raising revenues to carry out the legitimate objects of government. The underlying basis for its exercise is governmental necessity for without it no government can exist nor endure. Accordingly, it has the broadest scope of all the powers of government because in the absence of limitations, it is considered as unlimited, plenary, comprehensive and supreme. The two limitations on the power of taxation are the inherent and constitutional limitations which are intended to prevent abuse on the exercise of the otherwise plenary and unlimited power. It is the Court's role to see to it that the exercise of the power does not transgress these limitations.

### Power of Taxation: Revocation of Exempting Statutes (1997)

"X" Corporation was the recipient in 1990 of two tax exemptions both from Congress, one law exempting the company's bond issues from taxes and the other exempting the company from taxes in the operation of its public utilities. The two laws extending the tax exemptions were revoked by Congress before their expiry dates. Were the revocations constitutional?

**SUGGESTED ANSWER:**

Yes. The exempting statutes are both granted unilaterally by Congress in the exercise of taxing powers. Since taxation is the rule and tax exemption, the exception, any tax exemption unilaterally granted can be withdrawn at the pleasure of the taxing authority without violating the Constitution (***Mactan Cebu International Airport Authority v, Marcos, G.R No. 120082, September 11, 1996***).

Neither of these were issued by the taxing authority in a contract lawfully entered by it so that their revocation would not constitute an impairment of the obligations of contracts.

**ALTERNATIVE ANSWER:**

No. The withdrawal of the tax exemption amounts to a deprivation of property without due process of law, hence unconstitutional.

### Power of Taxation; Inherent in a Sovereign State (2005)

Describe the power of taxation. May a legislative body enact laws to raise revenues in the absence of a constitutional provision granting said body the power to tax? Explain.

**SUGGESTED ANSWER:**

Yes, the legislative body may enact laws even in the absence of a constitutional provision because the power to tax is inherent in the government and not merely a constitutional grant. The power of taxation is an essential and inherent attribute of sovereignty belonging as a matter of right to every independent government without being expressly granted by the people. ***(Pepsi-Cola Bottling Company of the Philippines, Inc. v. Municipality of Tanauan, Leyte, G.R. No. L-31156, February 27,1976)***

Taxation is the inherent power of a State to collect enforced proportional contribution to support the expenses of government. Taxation is the power vested in the legislature to impose burdens or charges upon persons and property in order to raise revenue for public purposes.

The power to tax is so unlimited in force and so searching in extent that courts scarcely venture to declare it is

subject to any restrictions whatever, except such as rest in the discretion of the authority which exercises it. ***(Tio v. Videogram Regulatory Board, G.R. No. L-75697, June 18, 1987)*** So potent is the power to tax that it was once opined that "the power to tax involves the power to destroy." ***(C.J. Marshall in McCulloch v. Maryland, 4 Wheat, 316 4 L. Ed. 579, 607)***

### Power of Taxation; Legislative in Nature (1996)

What is the nature of the power of taxation?

**SUGGESTED ANSWER:**

The POWER TO TAX is an attribute of sovereignty and is inherent in the State. It is a power emanating from necessity because it imposes a necessary burden to preserve the State's sovereignty ***(Phil Guarantee Co. vs. Commissioner, L-22074, April 30, 1965)***. It is inherently legislative in nature and character in that the power of taxation can only be exercised through the enactment of law.

**ALTERNATIVE ANSWER:**

The nature of the power of taxation refers to its own limitations such as the requirement that it should be for a public purpose, that it be legislative, that it is territorial and that it should be subject to international comity.

### Purpose of Taxation; Interpretation (2004)

Which of the following propositions may now be untenable:

1) The court should construe a law granting tax exemption strictly against the taxpayer.
2) The court should construe a law granting a municipal corporation the power to tax most strictly.
3) The Court of Tax Appeals has jurisdiction over decisions of the Customs Commissioner in cases involving liability for customs duties.
4) The Court of Appeals has jurisdiction to review decisions of the Court of Tax Appeals.
5) The Supreme Court has jurisdiction to review decisions of the Court of Appeals.

Justify your answer or choice briefly. (5%)

**SUGGESTED ANSWER:**

**2**. *The court should construe a law granting a municipal corporation the power to tax most strictly.*

This proposition is now untenable. The basic rationale for the grant of tax power to local government units is to safeguard their viability and self-sufficiency by directly granting them general and broad tax powers ***(Manila Electric Company v. Province of Laguna et. al., 306 SCRA 750 [1999])***. Considering that inasmuch as the power to tax may be exercised by local legislative bodies, no longer by valid congressional delegation but by direct authority conferred by the Constitution, in interpreting statutory provisions on municipal fiscal powers, doubts will, therefore, have to be resolved in favor of municipal corporations ***(City Government of San Pablo, Laguna v. Reyes, 305 SCRA 353 [1999]).*** This means that the court must adopt a liberal construction of a law granting a municipal corporation the power to tax.

> **Note:** If the examinee chose proposition **no. 4** as his answer, it should be given full credit considering that the present CTA Act (R.A. No. 9282) has made the CTA a coequal judicial body of the Court of Appeals. The question "Which of the following propositions may now be untenable" may lead the examinee to choose a proposition which is untenable on the basis of the new law despite the cut-off date adopted by the Bar Examination Committee. R.A. No. 9282 was passed on March 30, 2004.

### Purpose of Taxation; Legislative in Nature (2004)

Taxes are assessed for the purpose of generating revenue to be used for public needs. Taxation itself is the power by which the State raises revenue to defray the expenses of government. A jurist said that a tax is what we pay for civilization.In our jurisdiction, which of the following statements may be erroneous:

1) Taxes are pecuniary in nature.
2) Taxes are enforced charges and contributions.
3) Taxes are imposed on persons and property within the territorial jurisdiction of a State.
4) Taxes are levied by the executive branch of the government.
5) Taxes are assessed according to a reasonable rule of apportionment.

Justify your answer or choice briefly. (5%)

**SUGGESTED ANSWER:**

**A. 4.** *Taxes are levied by the executive branch of government.*

This statement is erroneous because levy refers to the act of imposition by the legislature which is done through the enactment of a tax law. Levy is an exercise of the power to tax which is exclusively legislative in nature and character. Clearly, taxes are not levied by the executive branch of government. ***(JVPC v. Albay, 186 SCRA 198 [1990]).***

### Rule on Set-Off or Compensation of Taxes (1996)

X is the owner of a residential lot situated at Quirino Avenue, Pasay City. The lot has an area of 300 square meters. On June 1, 1994, 100 square meters of said lot owned by X was expropriated by the government to be used in the widening of Quirino Avenue, for P300.000.00 representing the estimated assessed value of said portion. From 1991 to 1995, X, who is a businessman, has not been paying his income taxes. X is now being assessed for the unpaid income taxes in the total amount of P150,000.00. X claims his income tax liability has already been compensated by the amount of P300.000.00 which the government owes him for the expropriation of his property. Decide.

**SUGGESTED ANSWER:**

The income tax liability of X can not be compensated with the amount owed by the Government as compensation for his property expropriated, taxes are of distinct kind, essence and nature than ordinary obligations. Taxes and debts cannot be the subject of compensation because the Government and X are not mutually creditors and debtors of each other and a claim for taxes is not a debt, demand, contract, or Judgment as is allowable to be set off. ***(Francia vs. IAC. G.R 76749, June 28. 1988)***

### Rule on Set-Off or Compensation of Taxes (2001)

May a taxpayer who has pending claims for VAT input credit or refund, set-off said claims against his other tax liabilities? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No. Set-off is available only if both obligations are liquidated and demandable. Liquidated debts are those where the exact amounts have already been determined. In the instant case, the claim of the taxpayer for VAT refund is still pending and the amount has still to be determined. A fortiori, the liquidated obligation of the taxpayer to the government can not, therefore, be set-off against the unliquidated claim which the taxpayer conceived to exist in his favor. (***Philex Mining Corp. v. CIR, GR No. 125704, August 29, 1998***).

**ALTERNATIVE ANSWER:**

No. Taxes and claims for refund cannot be the subject of set-off for the simple reason that the government and the taxpayer are not creditors and debtors of each other. There is a material distinction between a tax and a claim for refund. Claims for refunds just like debts are due from the government in its corporate capacity, while taxes are due to the government in its sovereign capacity. (***Philex Mining Corp. v. CIR, GR No. 125704, August 29, 1998***).

### Rule on Set-Off or Compensation of Taxes (2005)

May taxes be the subject of set-off or compensation? Explain.

**SUGGESTED ANSWER.**

No, taxes cannot be the subject of set-off or compensation for the following reasons:

1) The lifeblood theory requires that there should be no unnecessary impediments to the collection of taxes to make available to the government the wherewithal to meet its legitimate objectives; and

2) The payment of taxes is not a contractual obligation but arises out of a duty to pay, and in respect of the positive acts of government, regarding the making and enforcing of taxes, the personal consent of the individual taxpayer is not required. ***(Republic v. Mambulao Lumber Co., G.R. No. L-17725, February 28, 1962; Caltex v. Commission on Audit, G.R. No. 92585, May 8, 1992; and Philex v. Commissioner of Internal Revenue, G.R. No. 125704, August 28, 1998)***

However, there is a possibility that set-off may arise, if the claims against the government have been recognized and an amount has already been appropriated for that purpose. Where both claims have already become overdue and demandable as well as fully liquidated. Compensation takes place by operation of law under Art. 1200 in relation to Articles 1279 and 1290 of the New Civil Code. ***(Domingo v. Garlitos, G.R. No. L-18994, June 29, 1963)***

### Rule on Set-Off or Compensation on Taxes (2005)

Can an assessment for a local tax be the subject of set-off or compensation against a final judgment for a sum of money obtained by the taxpayer against the local government that made the assessment? Explain.

**SUGGESTED ANSWER:**

No, taxes cannot be the subject of set-off even when there is a final judgment for a sum of money against the local government making the assessment. The government and the taxpayer are not the "mutual creditors and debtors" of each other who can avail of the remedy of compensation which Art. 1278 (Civil Code) is referring to ***Republic of the Philippines v. Mambulao Lumber Co., G.R. No. L-17725, February 28, 1962; and Francia v. Intermediate Appellate Court, G.R. No. L-67649, June 28,1998.***

There is, however, legal basis to state that an assessment for a local tax may be the subject of set-off or compensation against a final judgment for a sum of money obtained by the taxpayer against the local government by operation of law where the local government and the taxpayer are in their own right reciprocally debtors and creditors of each other, and that the debts are both due and demandable. This is consistent with the ruling in ***Domingo v. Garlitos, G.R. No. L-18994, June 29,1963,*** relying upon Arts. 1278 and 1279 of the Civil Code, where these provisions were applied in relation to the national tax, and should therefore be applicable to a local tax.

### Tax Avoidance vs. Tax Evasion (1996)

Distinguish tax evasion from tax avoidance.

**SUGGESTED ANSWER:**

Tax evasion is a scheme used outside of those lawful means to escape tax liability and, when availed of, it usually subjects the taxpayer to further or additional civil or criminal liabilities. Tax avoidance, on the other hand, is a tax saving device within the means sanctioned by law, hence legal.

### Tax Avoidance vs. Tax Evasion (2000)

Mr. Pascual's income from leasing his property reaches the maximum rate of tax under the law. He donated one-half of his said property to a non-stock, non-profit educational institution whose income and assets are actually, directly and exclusively used for educational purposes, and therefore qualified for tax exemption under Article XIV, Section 4 (3) of the Constitution and Section 30 (h) of the Tax Code. Having thus transferred a portion of his said asset, Mr. Pascual succeeded in paying a lesser tax on the rental income derived from his property. Is there tax avoidance or tax evasion? Explain. (2%)

**SUGGESTED ANSWER:**

There is tax avoidance. Mr. Pascual has exploited a fully permissive alternative method to reduce his income tax by transferring part of his rental income to a tax exempt entity through a donation of one-half of the income producing property. The donation is likewise exempt from the donor's tax. The donation is the legal means employed to transfer the incidence of income tax on the rental income.

### Tax Exemptions: Nature & Coverage; Proper Party (2004)

As an incentive for investors, a law was passed giving newly established companies in certain economic zone exemption from all taxes, duties, fees, imposts and other charges for a period of three years. ABC Corp. was organized and was granted such incentive. In the course of business, ABC Corp. purchased mechanical equipment from XYZ Inc. Normally, the sale is subject to a sales tax.

XYZ Inc. claims, however, that since it sold the equipment to ABC Corp. which is tax exempt, XYZ

should not be liable to pay the sales tax. Is this claim tenable? (5%)

**SUGGESTED ANSWER:**

A. No. Exemption from taxes is personal in nature and covers only taxes for which the taxpayer-grantee is directly liable. The sales tax is a tax on the seller who is not exempt from taxes. Since XYZ Inc. is directly liable for the sales tax and no tax exemption privilege is ever given to him, therefore, its claim that the sale is tax exempt is not tenable. A tax exemption is construed in *strictissimi juris* and it can not be permitted to exist upon vague implications ***(Asiatic Petroleum Co., Ltd. V. Llanes, 49 Phil 466 [1926]).***

Assume arguendo that XYZ had to and did pay the sales tax. ABC Corp. later found out, however, that XYZ merely shifted or passed on to ABC the amount of the sales tax by increasing the purchase price. ABC Corp. now claims for a refund from the Bureau of Internal Revenue in an amount corresponding to the tax passed on to it since it is tax exempt. Is the claim of ABC Corp. meritorious? (5%)

**SUGGESTED ANSWER;**

B. No. The claim of ABC Corp. is not meritorious. Although the tax was shifted to ABC Corp. by the seller, what is paid by it is not a tax but part of the cost it has assumed. Hence, since ABC Corp. is not a taxpayer, it has no capacity to file a claim for refund. The taxpayer who can file a claim for refund is the person statutorily liable for the payment of the tax.

### Tax Laws; BIR Ruling; Non-Retroactivity of Rulings (2004)

Due to an uncertainty whether or not a new tax law is applicable to printing companies, DEF Printers submitted a legal query to the Bureau of Internal Revenue on that issue. The BIR issued a ruling that printing companies are not covered by the new law. Relying on this ruling, DEF Printers did not pay said tax.

Subsequently, however, the BIR reversed the ruling and issued a new one stating that the tax covers printing companies. Could the BIR now assess DEF Printers for back taxes corresponding to the years before the new ruling? Reason briefly. (5%)

**SUGGESTED ANSWER:**

No. Reversal of a ruling shall not be given a retroactive application if said reversal will be prejudicial to the taxpayer. Therefore, the BIR can not assess DEF printers for back taxes because it would be violative of the principle of non-retroactivity of rulings and doing so would result in grave injustice to the taxpayer who relied on the first ruling in good faith ***(Section 246, NIRC; CIR v. Burroughs, Inc., 142 SCRA 324[1986]).***

### Tax Pyramiding; Definition & Legality (2006)

What is tax pyramiding? What is its basis in law? (5%)

**SUGGESTED ANSWER:**

Tax Pyramiding is the imposition of a tax upon another tax. It has no basis in fact or in law ***(People v. Sandiganbayan, G.R. No. 152532, August 16, 2005).*** There is also tax pyramiding when sales taxes are incorrectly applied to goods several times from production to final sale, thus, shifting the tax burden to the ultimate consumer.

*(**NOTABENE**: This concept pertains to the VAT law which is excluded from the bar coverage, Guidelines for 2006 Bar Examinations, June 15, 2006)*

### Taxpayer Suit; When Allowed (1996)

When may a taxpayer's suit be allowed?

**SUGGESTED ANSWER:**

A taxpayer's suit may only be allowed when an act complained of, which may include a legislative enactment, directly involves the illegal disbursement of public funds derived from taxation (***Pascual vs. Secretary of Public Works, 110 Phil. 331***).

### Uniformity in the Collection of Taxes (1998)

Explain the requirement of uniformity as a limitation in the imposition and/or collection of taxes. (5%|

**SUGGESTED ANSWER:**

Uniformity in the imposition and/or collection of taxes means that all taxable articles, or kinds of property of the same class shall be taxed at the same rate. The requirement of uniformity is complied with when the tax operates with the same force and effect in every place where the subject of it is found ***(Churchill & Tail v. Conception, 34 Phil. 969)***. It does not mean that lands, chattels, securities, income, occupations, franchises, privileges, necessities and luxuries shall be assessed at the same rate. Different articles maybe taxed at different amounts provided that the rate is uniform on the same class everywhere with all people at all times. Accordingly, singling out one particular class for taxation purposes does not infringe the requirement of uniformity.

**FIRST ALTERNATIVE ANSWER:**

The criteria is met when the tax laws operate equally and uniformly on all persons under similar circumstances. All persons are treated in the same manner, the conditions not being different, both in privileges conferred and liabilities imposed. Uniformity in taxation also refers to geographical uniformity. Favoritism and preference is not allowed.

**SECOND ALTERNATIVE ANSWER:**

A tax is deemed to have satisfied the uniformity rule when it operates with the same force and effect in every place where the subject maybe found. ***(Phil. Trust & Co. v. Yatco, 69 Phil. 420).***

# INCOME TAXATION

### Basic: Allowable Deductions vs. Personal Exemptions (2001)

Distinguish Allowable Deductions from Personal Exemptions. Give an example of an allowable deduction and another example for personal exemption. (5%)

**SUGGESTED ANSWER:**

The distinction between allowable deductions and personal exemptions are as follows:

a. ***As to amount*** — Allowable deductions generally refer to actual expenses incurred in the pursuit of trade, business or practice of profession while

personal exemptions are arbitrary amounts allowed by law.

b. ***As to nature*** — Allowable deductions constitute business expenses while personal exemptions pertain to personal expenses.

c. ***As to purpose*** — Deductions are allowed to enable the taxpayer to recoup his cost of doing business while personal exemptions are allowed to cover personal, family and living expenses.

d. ***As to claimants*** — Allowable deductions can be claimed by all taxpayers, corporate or otherwise, while personal exemptions can be claimed only by individual taxpayers.

### Basic: Meaning of Taxable Income (2000)

What is meant by taxable income? (2%)

**SUGGESTED ANSWER:**

TAXABLE INCOME means the pertinent items of gross income specified in the Tax Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the Tax Code or other special laws. *(Sec. 31, NIRC of 1997)*

### Basic: Principle of *Mobilia Sequuntur Personam* (1994)

What is the principle of *mobilia sequuntur personam* in income taxation?

**SUGGESTED ANSWER:**

Principle of *Mobilia Sequuntur Personam* in income taxation refers to the principle that taxation follows the property or person who shall be subject to the tax.

### Basic: Proper Allowance of Depreciation (1998)

2. What is the proper allowance for depreciation of any property used in trade or business? [3%)
3. What is the annual depreciation of a depreciable fixed asset with a cost of P100,000 and an estimated useful life of 20 years and salvage value of P 10,000 after its useful life?

**SUGGESTED ANSWER:**

1. The ***proper allowance of depreciation*** of any property used in trade or business refers to the reasonable allowance for the exhaustion, wear and tear *(including reasonable allowance for obsolescence)* of said property. The reasonable allowance shall include, but not limited to, an allowance computed under any of the following methods:
   (a) straight-line method;
   (b) declining-balance method;
   (c) sum-of-years-digit method; and
   (d) any other method which may be prescribed by the Secretary of Finance upon recommendation of the Commissioner of Internal Revenue (Sec. 34(F). NIRC).

2. The annual depreciation of the depreciable fixed asset may be computed on the straight-line method which will allow the taxpayer to deduct an annual depreciation of Php4,500, arrived at by dividing the depreciable value (Php l00.000-Phpl0.000) of Php90,000 by the estimated useful life (20 years).

**NOTE:** The bar candidate may give a different figure depending on the method he used in computing the annual depreciation. The facts given in the problem are sufficient to compute the annual depreciation either under the declining-balance method or sum-of-years-digit method. Any answer arrived at by using any of the recognized methods should be given full credit. It is suggested that no question requiring computation should be given in future bar examinations.

### Basic: Sources of Income: Taxable Income (1998)

From what sources of income are the following persons/corporations taxable by the Philippine government?

2) Citizen of the Philippines residing therein; [1%]
3) Non-resident citizen; [1%1
4) An individual citizen of the Philippines who is working and deriving income from abroad as an overseas contract worker; [1%]
5) An alien individual, whether a resident or not of the Philippines; [1%]
6) A domestic corporation; [1%]

**SUGGESTED ANSWER:** (Section 23, NIRC of 1997)

1) A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines.
2) A nonresident citizen is taxable only on income derived from sources within the Philippines.
3) An individual citizen of the Philippines who is working and deriving income from abroad as an overseas contract worker is taxable only on income from sources within the Philippines.
4) An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines.
5) A domestic corporation is taxable on all income derived from sources within and without the Philippines.

### Basic: Tax Benefit Rule (2003)

(a) What is meant by the "tax benefit rule"?

**SUGGESTED ANSWER:**

(a) TAX BENEFIT RULE states that the taxpayer is obliged to declare as taxable income subsequent recovery of bad debts in the year they were collected to the extent of the tax benefit enjoyed by the taxpayer when the bad debts were written-off and claimed as a deduction from income. It also applies to taxes previously deducted from gross income but which were subsequently refunded or credited. The taxpayer is also required to report as taxable income the subsequent tax refund or tax credit granted to the extent of the tax benefit the taxpayer enjoyed when such taxes were previously claimed as deduction from income.

(b) Give an illustration of the application of the tax benefit rule.

**SUGGESTED ANSWER:**

(b) X Company has a business connected receivable amounting to P100,000.00 from Y who was declared bankrupt by a competent court. Despite earnest efforts to collect the same, Y was not able to pay, prompting X Company to write-off the entire liability. During the year of write-off, the entire amount was claimed as a deduction for income tax purposes reducing the taxable net income of X Company to only P1,000,000.00. Three years later, Y

voluntarily paid his obligation previously written-off to X Company. In the year of recovery, the entire amount constitutes part of gross income of X Company because it was able to get full tax benefit three years earlier.

### Basic; Basis of Income Tax (1996)

X is employed as a driver of a corporate lawyer and receives a monthly salary of P5,000.00 with free board and lodging with an equivalent value of P1,500.00.

1. What will be the basis of X's income tax? Why
2. Will your answer in question (a) be the same if X's employer is an obstetrician? Why?

**SUGGESTED ANSWERS:**

1) The basis of X's income tax would depend on whether his employer is an employee or a practicing corporate lawyer.

- If his employer is an employee, the basis of X's income tax is P6,500.00 equivalent to the total of the basic salary and the value of the board and lodging. This is so because the employer/corporate lawyer has no place of business where the free board and lodging may be given.
- On the other hand, if the corporate lawyer is a "practicing lawyer (self-employed), X should be taxed only on P5,000.00 provided that the free board and lodging is given in the business premises of the lawyer and for his convenience and that the free lodging was given to X as a condition for employment.

2) If the employer is an obstetrician who is self-employed, the basis of X's income will only be P5,000.00 if it is proven that the free board and lodging is given within the business premises of said employer for his convenience and that the free lodging is required to be accepted by X as condition for employment. Otherwise, X would be taxed on P6,500.00.

### Basic; Gross Income: Define (1995)

What is "gross Income" for purposes of the Income tax?

**SUGGESTED ANSWER:**

GROSS INCOME means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, and similar items; gross income from business; gains derived from dealings in property; interest; rents; royalties; dividends; annuities; prizes and winnings; pensions; and partner's distributive share of the gross income of general professional partnership (Sec. 28, NIRC).

**ALTERNATIVE ANSWER:**

a) Gross income means all wealth which flows into the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits including gains derived from the sale or other disposition of capital.

b) Gross income means income (in the broad sense) less income which is, by statutory provision or otherwise, exempt from the tax imposed by law (Sec. 36, Rev. Reg. No. 2). Gross income from business means total sales, less cost of goods sold, plus any income from investments and from incidental or outside operations or sources (Sec. 43, Rev. Reg. No. 2).

### Basic; Income vs. Capital (1995)

How does "Income" differ from "capital"? Explain.

**SUGGESTED ANSWER:**

Income differs from capital in that INCOME is any wealth which flows into the taxpayer other than a return of capital while capital constitutes the investment which is the source of income. Therefore, capital is fund while income is the flow. Capital is wealth, while income is the service of wealth. Capital is the tree while income is the fruit (***Vicente Madrigal et al v. James Rqfferty, 38 Phil. 414***).

### Basic; Schedular Treatment vs. Global Treatment (1994)

Distinguish "*schedular treatment*" from "*global treatment*" as used in income taxation.

**SUGGESTED ANSWER:**

Under a SCHEDULER SYSTEM, the various types/items of income *(compensation; business/professional income)* are classified accordingly and are accorded different tax treatments, in accordance with schedules characterized by graduated tax rates. Since these types of income are treated separately, the allowable deductions shall likewise vary for each type of income.

Under the GLOBAL SYSTEM, all income received by the taxpayer are grouped together, without any distinction as to the type or nature of the income, and after deducting therefrom expenses and other allowable deductions, are subjected to tax at a fixed rate.

### Compensation; Income Tax: Due to Profitable Business Deal (1995)

Mr. Osorio, a bank executive, while playing golf with Mr. Perez, a manufacturing firm executive, mentioned to the latter that his (Osorio) bank had just opened a business relationship with a big foreign importer of goods which Perez' company manufactures. Perez requested Osorio to introduce him to this foreign importer and put in a good word for him (Perez), which Osorio did. As a result, Perez was able to make a profitable business deal with the foreign Importer.

In gratitude, Perez, in behalf of his manufacturing firm, sent Osorio an expensive car as a gift. Osorio called Perez and told him that there was really no obligation on the part of Perez or his company to give such an expensive gift. But Perez insisted that Osorio keep the car. The company of Perez deducted the cost of the car as a business expense.

The Commissioner of Internal Revenue included the fair market value of the car as Income of Osorio who protested that the car was a gift and therefore excluded from income. Who is correct, the Commissioner or Osorio? Explain.

**SUGGESTED ANSWER:**

The Commissioner is correct. The car having been given to Mr. Osorio in consideration of having introduced Mr. Perez to a foreign Importer which resulted to a profitable business deal is considered to be a compensation for

services rendered. The transfer is not a gift because it is not made out of a detached or disinterested generosity but for a benefit accruing to Mr. Perez. The fact that the company of Mr. Perez takes a business deduction for the payment indicates that it was considered as a pay rather than a gift. Hence, the fair market value of the car is includable in the gross income pursuant to Section 28(a)(l) of the Tax Code *(See 1974 Federal Tax Handbook, p. 145).* A payment though voluntary, if it is in return for services rendered, or proceeds from the constraining force of any moral or legal duty or a benefit to the payer is anticipated, is a taxable income to the payee even if characterized as a 'gift' by the payor ***(Commissioner vs. Duberstein, 363 U.S. 278).***

**ALTERNATIVE ANSWER:**

Mr. Osorio is correct. The car was not payment for services rendered. There was no prior agreement or negotiations between Mr. Osorio and Mr. Perez that the former will be compensated for his services. Mr. Perez, in behalf of his company, gave the car to Mr. Osorio out of gratitude. The transfer having been made gratuitously should be treated as a gift subject to donor's tax and should be excluded from the gross income of the recipient, Mr. Osorio. The Commissioner should cancel the assessment of deficiency income tax to Mr. Osorio and instead assess deficiency donor's tax on Mr Perez' company. (Sec. 28(b)(3), NIRC; ***Pirovano vs. Commissioner***)

### Corporate: Income: Donor's tax; Tax Liability (1996)

X, a multinational corporation doing business in the Philippines donated 100 shares of stock of said corporation to Mr. Y, its resident manager in the Philippines.

1) What is the tax liability, if any, of X corporation?
2) Assuming the shares of stocks were given to Mr. Y in consideration of his services to the corporation, what are the tax implications? Explain.

**SUGGESTED ANSWERS:**

1) Foreign corporations effecting a donation are subject to donor's tax only if the property donated is located in the Philippines. Accordingly, donation of a foreign corporation of its own shares of stocks in favor of resident employee is not subject to donor's tax (BIR Ruling No. 018-87, January 26, 1987). However, if 85% of the business of the foreign corporation is located in the Philippines or the shares donated have acquired business situs in the Philippines, the donation may be taxed in the Philippines subject to the rule of reciprocity.

2) If the shares of stocks were given to Mr. Y in consideration of his services to the corporation, the same shall constitute taxable compensation income to the recipient because it is a compensation for services rendered under an employer-employee relationship, hence, subject to income tax.

The par value or stated value of the shares issued also constitutes deductible expense to the corporation provided it is subjected to withholding tax on wages.

### Corporate; Income Tax; Reasonableness of the Bonus (2006)

Gold and Silver Corporation gave extra 14th month bonus to all its officials and employees in the total amount of P75 Million. When it filed its corporate income tax return the following year, the corporation declared a net operating loss. When the income tax return of the corporation was reviewed by the BIR the following year, it disallowed as item of deduction the P75 Million bonus the corporation gave its officials and employees on the ground of unreasonableness. The corporation claimed that the bonus is an ordinary and necessary expense that should be allowed. If you were the BIR Commissioner, how will you resolve the issue? (5%)

**SUGGESTED ANSWER:**

I will disallow the expense. A bonus is ordinary and necessary where said expenditure is (1) appropriate and helpful in the development of the taxpayers business *(Martens, Law of Federal Income Taxation, Volume IV, p. 315)* and (2) is normal in relation to the business of the taxpayer and the surrounding circumstances *(p. 316, Ibid).*

To determine the reasonableness of the bonus it must be commensurate with services performed by the officials and employees. Other factors to consider are whether the payment was made in good faith; the character of the taxpayer's business; the volume and amount of its net earnings; its locality; the type and extent of the services rendered; the salary policy of the corporation; the size of the particular business; the employees' qualification and contributions to the business venture; and general economic conditions ***(Atlas Mining v. CIR, G.R. No. L-26911, January 27, 1981)***. However, since the business suffers from a net operating loss, I will rule that the bonus is an unreasonable expense.

### Corporate; Income: Coverage; "Off-Line" Airline (1994)

Caledonia Aircargo is an off-line international carrier without any flight operations in the Philippines. It has, however, a liaison office in the Philippines which is duly licensed with the Securities and Exchange Commission, established for the purpose of providing passenger and flight information, reservation and ticketing services.

Are the revenues of Caledonia Aircargo from tickets reserved by its Philippine office subject to tax?

**SUGGESTED ANSWER:**

The revenues in the Philippines of Caledonia Aircargo as an "off-line" airline from ticket reservation services are taxable income from "whatever source" under Sec. 28(a) of the Tax Code. This case is analogous to ***Commissioner v. BOAC, G.R No. No. 65773-74, April 30, 1987*** where the Supreme Court ruled that the income received in the Philippines from the sale of tickets by an "off-line" airline is taxable as income from whatever source.

### Corporate; Income: Coverage; "Off-Line" Airline (2005)

An international airline with no landing rights in the Philippines sold tickets in the Philippines for air transportation. Is income derived from such sales of tickets considered taxable income of the said international

air carrier from Philippine sources under the Tax Code? Explain. (5%)

**ALTERNATIVE ANSWER:**

Yes. The income derived from the sales of tickets in the Philippines is considered taxable income of the international air carrier from Philippine sources.

The source of income is the property, activity or service that produced the income. The sale of tickets in the Philippines is the activity that produces the income. The absence of landing rights in the Philippines cannot alter the fact that revenues were derived from ticket sales within the Philippines. ***(Commissioner of Internal Revenue v. Japan Air Lines, G.R. No. 60714, October 4, 1991 reiterating British Overseas Airways Corp., Air India and American Airlines, Inc.)***

**ALTERNATIVE ANSWER:**

No, under *Sec. 3 of R.R. No. 15-2002*, an off-line airline having a branch office or a sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights of its principal or head office, or for other airlines covering flights originating from Philippine ports or off-line flights, is not considered engaged in business as an international air carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax nor to the 3% common carrier's tax.

Based on the foregoing, the international airline company is not considered as engaged in business in the Philippines and is therefore a non-resident foreign corporation. A non-resident foreign corporation is subject to the gross income tax on its income derived from sources within the Philippines. The income from sale of tickets shall not form part of taxable income because the term "taxable income" as defined under Sec. 31 of the NIRC refers only to income of those taxpayers who pay by way of the net income tax. Taxable income means the pertinent items of gross income specified in the NIRC, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the NIRC or other special laws.

### Dividends: Disguised dividends (1994)

Disguised dividends in income taxation? Give an example.

**SUGGESTED ANSWER:**

Disguised dividends are those income payments made by a domestic corporation, which is a subsidiary of a non-resident foreign corporation, to the latter ostensibly for services rendered by the latter to the former, but which payments are disproportionately larger than the actual value of the services rendered. In such case, the amount over and above the true value of the service rendered shall be treated as a dividend, and shall be subjected to the corresponding tax of 35% on Philippine sourced gross income, or such other preferential rate as may be provided under a corresponding Tax Treaty.

***Example:*** Royalty payments under a corresponding licensing agreement.

### Dividends; Income Tax; Deductible Gross Income (1999)

A Co., a Philippine corporation, issued preferred shares of stock with the following features:

1) Non-voting;
2) Preferred and cumulative dividends at the rate of 10% per annum, whether or not in any period the amount is covered by earnings or projects;
3) In the event of dissolution of the issuer, holders of preferred stock shall be paid in full or ratably as the assets of the issuer may permit before any distribution shall be made to common stockholders; and
4) The issuer has the option to redeem the preferred stock.

A Co. declared dividends on the preferred stock and claimed the dividends as interests deductible from its gross Income for income tax purposes. The BIR disallowed the deduction. A Co. maintains that the preferred shares with their features are really debt and therefore the dividends are realty interests. Decide. (10%)

**SUGGESTED ANSWER:**

The dividends are not deductible from gross income. Preferred shares shall be considered capital regardless of the conditions under which such shares are issued and, therefore, dividends paid thereon are not considered 'interest' which are allowed to be deducted from the gross income of the corporation. *(Revenue Memorandum Circular No. 17-71, July 12, 1971).*

### Effect; Condonation of Loan in Taxation (1995)

Mr. Francisco borrowed P10,000.00 from his friend Mr. Gutierrez payable in one year without interest. When the loan became due Mr. Francisco told Mr. Gutierrez that he (Mr. Francisco) was unable to pay because of business reverses. Mr. Gutierrez took pity on Mr. Francisco and condoned the loan. Mr. Francisco was solvent at the time he borrowed the P 10,000.00 and at the time the loan was condoned. Did Mr. Francisco derive any income from the cancellation or condonation of his indebtedness? Explain.

**SUGGESTED ANSWER:**

No, Mr. Francisco did not derive any income from the cancellation or condonation of his indebtedness. Since it is obvious that the creditor merely desired to benefit the debtor in view of the absence of consideration for the cancellation, the amount of the debt is considered as a gift from the creditor to the debtor and need not be included in the latter's gross income.

### Fringe Benefit Tax: Covered Employees (2001)

X was hired by Y to watch over V's fishponds with a salary of Php 10,000.00. To enable him to perform his duties well, he was also provided a small hut, which he could use as his residence in the middle of the fishponds. Is the fair market value of the use of the small hut by X a "fringe benefit" that is subject to the 32% tax imposed by Section 33 of the National Internal Revenue Code? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No. X is neither a managerial nor a supervisory employee. Only managerial or supervisory employees are entitled to a fringe benefit subject to the fringe benefits tax. Even assuming that he is a managerial or supervisory employee, the small hut is provided for the convenience of the

employer, hence does not constitute a taxable fringe benefit. *(Section 33, NERC).*

### Fringe Benefit Tax: Employer required to Pay (2003)

A "fringe benefit" is defined as being any good, service or other benefit furnished or granted in cash or in kind by an employer to an individual employee. Would it be the employer or the employee who is legally required to pay an income tax on it? Explain. (4%)

**SUGGESTED ANSWER:**

It is the employer who is legally required to pay an income tax on the fringe benefit. The fringe benefit tax is imposed as a FINAL WITHHOLDING TAX placing the legal obligation to remit the tax on the employer, such that, if the tax is not paid the legal recourse of the BIR is to go after the employer. Any amount or value received by the employee as a fringe benefit is considered tax paid hence, net of the income tax due thereon. The person who is legally required to pay *(same as statutory incidence as distinguished from economic incidence)* is that person who, in case of non-payment, can be legally demanded to pay the tax.

### Interest: Deficiency Interest: define (1995 Bar)

What is a "deficiency interest" for purposes of the income tax? Illustrate.

**SUGGESTED ANSWER:**

DEFICIENCY INTEREST for purposes of the income tax is the interest due on any amount of tax due or installment thereof which is not paid on or before the date prescribed for its payment computed at the rate of 20% per annum or the Manila Reference Rate, whichever is higher, from the date prescribed for its payment until it is fully paid.

If for example after the audit of the books of XYZ Corp. for taxable year 1993 there was found to be due a deficiency income tax of P125,000.00 inclusive of the 25% surcharge imposed under Section 248 of the Tax Code, the interest will be computed on the P125.000.00 from April 15, 1994 up to its date of payment.

### Interest: Delinquency Interest: define (1995)

What is a "delinquency interest" for purposes of the income tax? Illustrate.

**SUGGESTED ANSWER:**

Delinquency interest is the interest of 20% or the Manila Reference Rate, whichever is higher, required to be paid in case of failure to pay:

(a) the amount of the tax due on any return required to be filed; or
(b) the amount of the tax due for which return is required; or
(c) the deficiency tax or any surcharge or interest thereon, on the due date appearing in the notice and demand of the Commissioner of Internal Revenue.

If in the above illustration the assessment notice was released on December 31, 1994 and the amount of deficiency tax, inclusive of surcharge and deficiency interest were computed up to January 30, 1995 which is the due date for payment per assessment notice, failure to pay on this latter date will render the tax delinquent and will require the payment of delinquency interest.

### ITR: Personal Income; Exempted to File ITR (1997)

A bachelor was employed by Corporation A on the first working day of January 1996 on a part-time basis with a salary of P3,500.00 a month. He then received the 13th month pay. In September 1996, he accepted another part-time Job from Corporation B from which he received a total compensation of P14,500.00 for the year 1996. The correct total taxes were withheld from both earnings. With the withholding taxes already paid, would he still be required to file an income tax return for his 1996 income?

**SUGGESTED ANSWER:**

Yes, because what is exempt from filing are those individuals who have total compensation income not exceeding P60.000 with the taxes correctly withheld only by one employer. In this case, even if his aggregate compensation income from both his employers does not exceed P60.000 and that total withholding taxes were correctly withheld by his employers, the fact that he derives compensation income concurrently from two employers at anytime during the taxable year, does not exempt him from filing his income tax return *(RA 7497, as implemented by RR No. 4-93).*

### ITR; Domestic Corporate Taxation (1997)

During the year, a domestic corporation derived the following items of revenue: (a) gross receipts from a trading business; (b) interests from money placements in the banks; (c) dividends from its stock investments in domestic corporations; (d) gains from stock transactions through the Philippine Stock Exchange; (e) proceeds under an insurance policy on the loss of goods. In preparing the corporate income tax return, what should be the tax treatment on each of the above items?

**SUGGESTED ANSWER:**

The ***gross receipts from trading business*** is includible as an item of income in the corporate income tax return and subject to corporate income tax rate based on net income.

The other items of revenue will not be included in the corporate income tax return.

- The interest from money market placements is subject to a final withholding tax of 20%;
- The dividends from domestic corporation are exempt from income tax; and
- gains from stock transactions with the Philippine Stock Exchange are subject to transaction tax which is in lieu of the income tax.
- The proceeds under an insurance policy on the loss of goods is not an item of income but merely a return of capital hence not taxable.

**ALTERNATIVE ANSWER:**

The gross receipts from trading business is includible as an item of income in the corporate income tax return. Likewise, the gain or loss realized as a consequence of the receipt of proceeds under an insurance policy on the loss of goods will be included in the corporate income tax

return either as a taxable gain or a deductible loss. The gain or loss is arrived at by deducting from the proceeds of insurance (amount realized) the basis of the good lost (Sec. 34(a), NIRC). The net income of the corporation shall be subject to corporate income tax rate of 35%.

The other items of revenue will not be included in the corporate income tax return. The interest from money market placements is subject to a final withholding tax of 20%; dividends from domestic corporations are exempt from income tax; and gains from stock transactions with the Philippine Stock Exchange are subject to transaction tax which is in lieu of the income tax.

### ITR; Domestic Corporate Taxation (2001)

a) How often does a domestic corporation file income tax return for income earned during a single taxable year? Explain the process. (3%)

**SUGGESTED ANSWER:**

a) A domestic corporation is required to file income tax returns four (4) times for income earned during a single taxable year. Quarterly returns are required to be filed for the first three quarters where the corporation shall declare its quarterly summary of gross income and deductions on a cumulative basis. *(Section 75, NIRC).* Then, a final adjustment return is required to be filed covering the total taxable income for the entire year, calendar or fiscal. *(Section 76, NIRC).*

b) What is the reason for such procedure? (2%)

**SUGGESTED ANSWER:**

b) The reason for this procedure is to ensure the timeliness of collection to meet the budgetary needs of the government. Likewise, it is designed to ease the burden on the taxpayer by providing it with an installment payment scheme, rather than requiring the payment of the tax on a lump-sum basis after the end of the year.

**ALTERNATIVE ANSWER:**

b) The reason for the quarterly filing of tax returns is to allow partial collection of the tax before the end of the taxable year and also to improve the liquidity of government

### ITR; Personal Income: Two Employment (2001)

In the year 2000, X worked part time as a waitress in a restaurant in Mega Mall from 8:00 a.m. to 4:00 p.m. and then as a cashier in a 24-hour convenience store in her neighborhood. The total income of X for the year from the two employers does not exceed her total personal and additional exemptions for the year 2000. Was she required to file an income tax return last April? Explain your answer. (5%)

**SUGGESTED ANSWER:**

Yes. An individual deriving compensation concurrently from two or more employers at any time during the taxable year shall file an income tax return (Sec. 51(A)(2)(b), NIRC.)

**ALTERNATIVE ANSWER:**

It depends. An individual with pure compensation income is not required to file an income tax returns when she meets the following conditions; (1) the total gross compensation income does not exceed Php60,000.00 and (2) the income tax has been correctly withheld, meaning the tax withheld is equal to the tax due. *(Section 51(A)(2)(b), NIRC).*

There is no mention in the problem of the amount of personal and additional personal exemption to quantify how much is that compensation income that did not exceed the personal and additional personal exemptions. There is no, mention, either, of whether or not the employers withheld taxes and that the amount withheld is equal to the tax due. Whether or not she will be required to file an income tax return last April 15 on the 2000 income will depend on her compliance with the requirements of the law.

### ITR; Personal Income; GSIS Pension (2000)

Mr. Javier is a non-resident senior citizen. He receives a monthly pension from the GSIS which he deposits with the PNB-Makati Branch. Is he exempt from income tax and therefore not required to file an income tax return? (5%)

**SUGGESTED ANSWER:**

Mr. Javier is exempt from income tax on his monthly GSIS pension *(Sec. 32(B)(6)(f), NIRC of 1997)* but not on the interest income that might accrue on the pensions deposited with PNB which are subject to final withholding tax. Consequently, since Mr. Javier's sole taxable income would have been subjected to a final withholding tax, he is not required anymore to file an income tax return. *(Sec. 51 (A) (2) (c). Ibid].*

### ITR; Personal Income; Married Individual (2004)

RAM got married to LISA last January 2003. On November 30, 2003, LISA gave birth to twins. Unfortunately, however, LISA died in the course of her delivery. Due to complications, one of the twins also died on December 15, 2003.

In preparing his Income Tax Return (ITR) for the year 2003, what should RAM indicate in the ITR as his civil status: (a) single; (b) married; (c) Head of the family; (d) widower; (e) none of the above? Why? Reason. (5%)

**SUGGESTED ANSWER:**

RAM should indicate "(b) married" as his civil status in preparing his Income Tax Return for the year 2003. The death of his wife during the year will not change his status because should the spouse die during the taxable year, the taxpayer may still claim the same exemptions *(that of being married)* as if the spouse died at the close of such year *(Section 35/Cj, NIRC).*

### ITR; Taxpayer; Liabilities; Falsified Tax Return (2005)

Danilo, who is engaged in the trading business, entrusted to his accountant the preparation of his income tax return and the payment of the tax due. The accountant filed a falsified tax return by underdeclaring the sales and overstating the expense deductions by Danilo.

Is Danilo liable for the deficiency tax and the penalties thereon? What is the liability, if any, of the accountant? Discuss. (5%)

**SUGGESTED ANSWER:**

Danilo is liable for the deficiency tax as well as for the deficiency interest. He should not be held liable for the

fraud penalty because the accountant acted beyond the limits of his authority. There is no showing in the problem that Danilo signed the falsified return or that it was prepared under his direction.

{On the other hand the accountant may be held criminally liable for violation of the Tax Code when he falsified the tax return by underdeclaring the sale and overstating the expense deductions. If Danny's accountant is a Certified Public Accountant, his certificate as a CPA shall automatically be revoked or cancelled upon conviction.

### Partnership: Income Tax (1995)

Five years ago Marquez, Peneyra, Jayme, Posadas and Manguiat, all lawyers, formed a partnership which they named Marquez and Peneyra Law Offices. The Commissioner of Internal Revenue thereafter issued *Revenue Regulation No. 2-93 implementing RA. 7496* known as the Simplified Net Income Taxation Scheme (SNITS). Revenue Regulation No. 2-93 provides in part:

> ***Sec. 6. General Professional Partnership***. — The general professional partnership and the partners are covered by R.A. 7496. Thus, in determining profit of the partnership, only the direct costs mentioned in said law are to be deducted from partnership income. Also, the expenses paid or Incurred by partners in their individual capacities in the practice of their profession which are not reimbursed or paid by the partnership but are not considered as direct costs are not deductible from his gross income.

1) Marquez and Peneyra Law Offices filed a taxpayer's suit alleging that Revenue Regulation No. 2-93 violates the principle of uniformity in taxation because general professional partnerships are now subject to payment of income tax and that there is a difference in the tax treatment between individuals engaged in the practice of their respective professions and partners in general professional partnerships. Is this contention correct? Explain.

**SUGGESTED ANSWER:**

1) The contention is not correct. General professional partnerships remain to be a non-taxable entity. What is taxable are the partners comprising the same and they are obligated to report as income their share in the income of the general professional partnership during the taxable year whether distributed or not. The SNITS treat professionals as one class of taxpayer so that they shall be treated alike irrespective of whether they practice their profession alone or in association with other professionals under a general professional partnership. What are taxed differently are individuals and corporations. All individuals similarly situated are taxed alike under the regulations, therefore, the principle of uniformity in taxation is not violated. On the contrary, all the requirements of a valid classification have been complied with ***(Ton vs. Del Rosario et al G.R No. 109289, Octobers, 1994).***

2) Is Revenue Regulation No. 2-93 now considered as having adopted a gross income method instead of retaining the net income taxation scheme? Explain.

**SUGGESTED ANSWER:**

2) No. Revenue Regulation No. 2-93 implementing RA No. 7496 have indeed significantly reduced the items of deduction by limiting it to direct costs and expenses or the 40% of gross receipts maximum deduction in cases where the direct costs are difficult to determine. The allowance of limited deductions however, is still in consonance with the net income taxation scheme rather than the gross income method. While it is true that not all the expenses of earning the income might be allowed, this can well be justified by the fact that deductions are not matters of right but are matters of legislative grace.

### Personal; Income Tax: Non-Resident Alien (2000)

Mr. Cortez is a non-resident alien based in Hong Kong. During the calendar year 1999, he came to the Philippines several times and stayed in the country for an aggregated period of more than 180 days. How will Mr. Cortez be taxed on his income derived from sources within the Philippines and from abroad? (5%)

**SUGGESTED ANSWER:**

Mr. Cortez being a non-resident alien individual who has stayed for an aggregated period of more than 180 days during the calendar year 1999, shall for that taxable year be deemed to be a non-resident alien doing business in the Philippines.

Considering the above, Mr. Cortez shall be subject to an income tax in the same manner as an individual citizen and a resident alien individual, on taxable income received from all sources within the Philippines. *[Sec. 25 (A) (1), NIRC of 1997]* Thus, he is allowed to avail of the itemized deductions including the personal and additional exemptions but subject to the rule on reciprocity on the personal exemptions. *(Sec. 34 (A) to (J) and (M) in relation to Sec. 25 (A) (1), Ibid, Sec. 35 (D), Ibid.]*

> *NOTE: It is suggested that full credit should be given if the examinee's answer only cover the first two paragraphs.*

### Personal; Income Tax: Non-Resident Citizen (1999)

A Co., a Philippine corporation, has an executive (P) who is a Filipino citizen. A Co. has a subsidiary in Hong Kong (HK Co.) and will assign P for an indefinite period to work full time for HK Co. P will bring his family to reside in HK and will lease out his residence in the Philippines. The salary of P will be shouldered 50% by A Co. while the other 50% plus housing, cost of living and educational allowances of P's dependents will be shouldered by HK Co. A Co. will credit the 50% of P's salary to P's Philippine bank account. P will sign the contract of employment in the Philippines. P will also be receiving rental income for the lease of his Philippine residence. Are these salaries, allowances and rentals subject to the Philippine income tax? (5%)

**SUGGESTED ANSWER:**

The salaries and allowances received by P are not subject to Philippine income tax. P qualifies as a nonresident citizen because he leaves the Philippines for employment requiring him to be physically present abroad most of the time during the taxable year. *(Section 22(E), NIRC).* A non-resident citizen is taxable only on income derived from Philippine sources. *(Section 23, NIRC).* The salaries and

allowances received from being employed abroad are incomes from without because these are compensation for services rendered outside of the Philippines. *(Section 42, NIRC).*

However, P is taxable on rental income for the lease of his Philippine residence because this is an income derived from within, the leased property being located in the Philippines. *(Section 42, NIRC).*

### Personal; Income Tax: Tax-Free Exchange (1997)

Three brothers inherited in 1992 a parcel of land valued for real estate tax purposes at P3.0 million which they held in co-ownership. In 1995, they transferred the property to a newly organized corporation as their equity which was placed at the zonal value of P6.0 million. In exchange for the property, the three brothers thus each received shares of stock of the corporation with a total par value of P2.0 million or, altogether, a total of P6.0 million. No business was done by the Corporation, and the property remained idle. In the early part of 1997, one of the brothers, who was in dire need of funds, sold his shares to the two brothers for P2.0 million. Is the transaction subject to any internal revenue tax (other than the documentary stamp tax)?

**SUGGESTED ANSWER:**

Yes. The exchange in 1995 is a tax-free exchange so that the subsequent sale of one of the brothers of his shares to the other two (2) brothers in 1997 will be subject to income tax. This is so because the tax-free exchange merely deferred the recognition of income on the exchange transaction. The gain subject to income tax in the sale is measured by the difference between the selling price of the shares (P2 Million) and the basis of the real property in the hands of the transferor at the time of exchange which is the fair market value of his share in the real property at the time of inheritance (Section 34(b)(2), NIRC). The net gain from the sale of shares of stock is subject to the schedular capital gains tax of 10% for the first P100.000 and 20% for the excess thereof (Section 2l(d), NIRC).

**ALTERNATIVE ANSWER:**

The exchange effected in 1995 did not qualify as a tax-free exchange because there is no showing that the three brothers gained control of the corporation by acquiring at least 51% of the voting rights. Since the entire gain on the exchange was previously subjected to income tax, then, the sale will also be taxable if a gain results therefrom. In the instant case, the sale will not be subject to any internal revenue tax other than the documentary stamp tax, because the seller did not realize any gain from the sale. The gain is measured by the difference between the amount realized (selling price) and the basis of the property. Incidentally, the basis to him is his share in the value of the property received at the time of exchange, which is P2 Million, an amount, just equal to the amount realized from the sale.

### Personal; Income Tax; Contract of Lease (1995)

Mr. Domingo owns a vacant parcel of land. He leases the land to Mr. Enriquez for ten years at a rental of P12,000.00 per year. The condition is that Mr. Enriquez will erect a building on the land which will become the property of Mr. Domingo at the end of the lease without compensation or reimbursement whatsoever for the value of the building.

Mr. Enriquez erects the building. Upon completion the building had a fair market value of P1 Million. At the end of the lease the building is worth only P900.000.00 due to depreciation.

Will Mr. Domingo have income when the lease expires and becomes the owner of the building with a fair market value of P900.000.00? How much income must he report on the building? Explain.

**SUGGESTED ANSWER:**

When a building is erected by a lessee in the leased premises in pursuance of an agreement with the lessor that the building becomes the property of the lessor at the end of the lease, the lessor has the option to report income as follows:

1) The lessor may report as income the market value of the building at the time when such building is completed; or
2) The lessor may spread over the life of the lease the estimated depreciated value of such building at the termination of the lease and report as income for each year of the lease an aliquot part thereof (Sec. 49, RR No. 2).

Under the first option, the lessor will have no income when the lease expires and becomes the owner of the building. The second option will give rise to an income during the year of lease expiration of P90.000.00 or 1/10 of the depreciated value of the building.

The availment of the first option will require Mr. Domingo to report an income of P1.000,000.00 during the year when the building was completed. A total of P900.000.00 income will be reported under the second option but will be spread over the life of the lease or P90.000.00 per year.

**ALTERNATIVE ANSWER:**

Mr. Domingo will realize an income when the lease expires and becomes the owner of the building with a fair market value of P900.000.00 because the condition for the lease is the transfer of the building at the expiration of the lease. The income to be realized by Mr. Domingo at the time of the expiration will consist of the value of the building which is P900.000.00 and any rental income that has accrued as of said date.

### Personal; Income Tax; Married Individual (1997)

Mar and Joy got married in 1990. A week before their marriage. Joy received, by way of donation, a condominium unit worth P750.000.00 from her parents. After marriage, some renovations were made at a cost of P150.000.00. The spouses were both employed in 1991 by the same company. On 30 December 1992, their first child was born, and a second child was born on 07 November 1993. In 1994, they sold the condominium unit and bought a new unit. Under the foregoing facts, what

were the events in the life of the spouses that had income tax incidences?

**SUGGESTED ANSWER:**

The events in the life of spouses. Mar and Joy, which have income tax incidences are the following:

1) Their marriage in 1990 qualifies them to claim personal exemption for married individuals;
2) Their employment in 1991 by the same company will make them liable to the income tax imposed on gross compensation income;
3) Birth of their first child in December 1992 would give rise to an additional exemption of P5,000 for taxable year 1992;
4) Birth of their second child in November 1993 would likewise entitle them to claim additional exemption of P5,000 raising their additional personal exemptions to P 10,000 for taxable year 1993; and
5) Sale of their condominium unit in 1994 shall make the spouses liable to the 5% capital gains tax on the gain presumed to have been realized from the sale.

### Personal; Income Tax; Retiring Alien Employee (2005)

An alien employee of the Asian Development Bank (ADB) who is retiring soon has offered to sell his car to you which he imported tax-free for his personal use. The privilege of exemption from tax is granted to qualified personal use under the ADB Charter which is recognized by the tax authorities. If you decide to purchase the car, is the sale subject to tax? Explain. (5%)

**SUGGESTED ANSWER:**

The sales transaction is subject to value added tax (VAT) under Sec. 107(B) of the NIRC, although this provision is expressly excluded from the coverage of the 2005 bar exam.

The proceeds from the sale are subject to income tax. The car is considered a capital asset of the retiring alien employee because he is not engaged in the business of buying and selling cars. He therefore derived income, which should be reported in his income tax return. (Sees. 32 and 39, NIRC)

### Personal; Income Taxation: Non-Resident Citizen (1997)

Juan, a Filipino citizen, has immigrated to the United States where he is now a permanent resident. He owns certain income-earning property in the Philippines from which he continues to derive substantial income. He also receives income from his employment in the United States on which the US income tax is paid. On which of the above income is the taxable, if at all, in the Philippines, and how, in general terms, would such income or incomes be taxed?

**SUGGESTED ANSWER:**

Juan, shall be taxed on both his income from the Philippines and on his Income from the United States because his being a citizen makes him taxable on all Income wherever derived. For the income he derives from his property in the Philippines, Juan shall be taxed on his net income under the ***Simplified Net Income Taxation Scheme*** (SNITS) whereby he shall be considered as a self-employed individual. His Income as employee in the United States, on the other hand, shall be taxed in accordance with the schedular graduated rates of 1%, 2% and 3%. based on the adjusted gross income derived by non-resident citizens from all sources without the Philippines during each taxable year.

### Taxable Income: Illegal Income (1995 Bar)

Mr. Lajojo is a big-time swindler. In one year he was able to earn P1 Million from his swindling activities. When the Commissioner of Internal Revenue discovered his income from swindling, the Commissioner assessed him a deficiency income tax for such income. The lawyer of Mr. Lajojo protested the assessment on the following grounds:

1) The income tax applies only to legal income, not to illegal income;
2) Mr. Lajojo's receipts from his swindling did not constitute income because he was under obligation to return the amount he had swindled, hence, his receipt from swindling was similar to a loan, which is not income, because for every peso borrowed he has a corresponding liability to pay one peso; and
3) If he has to pay the deficiency income tax assessment, there will be hardly anything left to return to the victims of the swindling.

How will you rule on each of the three grounds for the protest? Explain.

**SUGGESTED ANSWERS:**

1) The contention that the income tax applies to legal income and not to illegal income is not correct. Section 28(a) of the Tax Code includes within the purview of gross income all Income from whatever source derived. Hence, the illegality of the income will not preclude the imposition of the income tax thereon.

2) The contention that the receipts from his swindling did not constitute income because of his obligation to return the amount swindled is likewise not correct. When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, he has received taxable income, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged to restore its equivalent ***(James vs. U.S.,366 U.S. 213, 1961).*** To treat the embezzled funds not as taxable income would perpetuate injustice by relieving embezzlers of the duty of paying income taxes on the money they enrich themselves with through embezzlement, while honest people pay their taxes on every conceivable type of income. *(James vs. U.S.)*

3) The deficiency income tax assessment is a direct tax imposed on the owner which is an excise on the privilege to earn an income. It will not necessarily be paid out of the same income that were subjected to the tax. Mr. Lajojo's liability to pay the tax is based on his having realized a taxable income from his swindling activities and will not affect his obligation to make restitution. Payment of the tax is a civil obligation imposed by law while restitution is a civil liability arising from a crime.

### Taxable or Non-Taxable; Income and Gains (2005)

Explain briefly whether the following items are taxable or non-taxable: (5%)

a) Income from ***JUETENG***;

**SUGGESTED ANSWER:**

Taxable. Gross income includes "all income derived from whatever source" *(Sec. 32[A], NIRC),* which was interpreted as all income not expressly excluded or exempted from the class of taxable income, irrespective of the voluntary or involuntary action of the taxpayer in producing the income. Thus, the income may proceed from a legal or illegal source such as from jueteng. Unlawful gains, gambling winnings, etc. are subject to income tax. The tax code stands as an indifferent neutral party on the matter of where the income comes from. ***(Commissioner of Internal Revenue v. Manning, G.R. No. L-28398, August 6, 1975)***

b) Gain arising from ***EXPROPRIATION OF PROPERTY***;

**SUGGESTED ANSWER:**

Taxable. Sale exchange or other disposition of property to the government of real property is taxable. It includes taking by the government through condemnation proceedings. ***(Gonzales v. Court of Tax Appeals, G.R. No. L-14532, May 26, 1965)***

c) ***TAXES*** paid and subsequently refunded;

**SUGGESTED ANSWER:**

Taxable only if the taxes were paid and claimed as deduction and which are subsequently refunded or credited. It shall be included as part of gross income in the year of the receipt to the extent of the income tax benefit of said deduction. *(Sec. 34[C][1], NIRC)* Not taxable if the taxes refunded were not originally claimed as deductions.

d) Recovery of ***BAD DEBTS*** previously charged off;

**SUGGESTED ANSWER:**

Taxable under the **TAX BENEFIT RULE**. Recovery of bad debts previously allowed as deduction in the preceding years shall be included as part of the gross income in the year of recovery to the extent of the income tax benefit of said deduction. *(Sec. 34[E][1], NIRC)* This is sometimes referred as the **RECAPTURE RULES**.

e) Gain on the sale of a car used for personal purposes.

**SUGGESTED ANSWER:**

Taxable. Since the car is used for personal purposes, it is considered as a capital asset hence the gain is considered income. *(Sec. 32[A][3] and Sec. 39[A][1], NIRC)*

### Withholding Tax: Non-Resident Alien (2001)

Is a non-resident alien who is not engaged in trade or business or in the exercise of profession in the Philippines but who derived rental income from the Philippines required to file an income tax return on April of the year following his receipt of said income? If not, why not? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No. The income tax on all income derived from Philippine sources by a non-resident alien who is not engaged in trade or business in the Philippines is withheld by the lessee as a Final Withholding Tax. *(Section 57(A), NIRC).* The government can not require persons outside of its territorial jurisdiction to file a return; for this reason, the income tax on income derived from within must be collected through the withholding tax system and thus relieve the recipient of the income the duty to file income tax returns. *(Section 51, NIRC).*

### Withholding Tax: Retirement Benefit (2000)

To start a business of his own, Mr. Mario de Guzman opted for an early retirement from a private company after ten (10) years of service. Pursuant to the company's qualified and approved private retirement benefit plan, he was paid his retirement benefit which was subjected to withholding tax. Is the employer correct in withholding the tax? Explain. (2%)

**SUGGESTED ANSWER:**

(a) It depends. An employee retiring under a company's qualified and private retirement plan can only be exempt from income tax on his retirement benefits if the following requisites are met:

(1) that the retiring employee must have been in service of the same employer for at least ten (10) years;
(2) that he is not less than 50 years of age at the time of retirement; and
(3) the benefit is availed of only once.

In the instant case, there is no mention whether the employee has likewise complied with requisites number (2) and (3).

### Withholding Tax: Retirement Benefit (2000)

Under what conditions are retirement benefits received by officials and employees of private firms excluded from gross income and exempt from taxation? (3%)

**SUGGESTED ANSWER:**

The conditions to be met in order that retirement benefits received by officials and employees of private firms are excluded from gross income and exempt from taxation are as follows:

2. Under Republic Act No. 4917 (those received under a reasonable private benefit plan):
    a. the retiring official or employee must have been in service of the same employer for at least ten (10) years;
    b. that he is not less than fifty (50) years of age at the time of retirement; and
    c. that the benefit is availed of only once.

3. Under Republic Act No. 7641 (those received from employers without any retirement plan):
    a. Those received under existing collective bargaining agreement and other agreements are exempt; and
    b. In the absence of retirement plan or agreement providing for retirement benefits the benefits are excluded from gross income and exempt from income tax if:
        i. retiring employee must have served at least five(5) years; and
        ii. that he is not less than sixty (60) years of age but not more than sixty five (65).

### Withholding Tax: Royalty (2002)

The MKB-Phils. is a BOI-registered domestic corporation licensed by the MKB of the United Kingdom to distribute, support and use in the Philippines its computer software systems, including basic and related materials for banks. The MKB-Phils. provides consultancy and technical services incidental thereto by entering into licensing agreements with banks. Under such agreements, the MKB-Phils. will not acquire any proprietary rights in the licensed systems. The MKB-Phils. pays royalty to the MKB-UK, net of 15% withholding tax prescribed by the RP-UK Tax Treaty.

Is the income of the MKB-Phils. under the licensing agreement with banks considered royalty subject to 20% final withholding tax? Why? If not, what kind of tax will its income be subject to? Explain. (5%)

**SUGGESTED ANSWER:**

Yes. The income of MKB-Phils. under the licensing agreement with banks shall be considered as royalty subject to the 20% final withholding tax. The term royalty is broad enough to include technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme. (Sec. 42(4)(f), NIRC). Accordingly, the consultancy and technical services rendered by MKB-Phils, which are incidental to the distribution, support and use of the computer systems of MKB-UK are taxable as royalty.

### Withholding Tax; Coverage (2004)

Citing Section 10, Article VIII of the 1987 Constitution which provides that salaries of judges shall be fixed by law and that during their continuance in office their salary shall not be decreased, a judge of MM Regional Trial Court questioned the deduction of withholding taxes from his salary since it results into a net deduction of his pay. Is the contention of the judge correct? Reason briefly. (5%)

**SUGGESTED ANSWER:**

No. The contention is incorrect. The salaries of judges are not tax-exempt and their taxability is not contrary to the provisions of Section 10, Article VIII of the Constitution on the non-diminution of the salaries of members of the judiciary during their continuance in office. The clear intent of the Constitutional Commission that framed the Constitution is to subject their salaries to tax as in the case of all taxpayers. Hence, the deduction of withholding taxes, being a manner of collecting the income tax on their salary, is not a diminution contemplated by the fundamental law. ***(Nitafan et. al. v. CIR, 152 SCRA 284 [1987***]).

### Withholding Tax; Domestic Corporation; Cash Dividends (2001)

What do you think is the reason why cash dividends, when received by a resident citizen or alien from a domestic corporation, are taxed only at the final tax of 10% and not at the progressive tax rate schedule under Section 24(A) of the Tax Code? Explain your answer. (5%)

**SUGGESTED ANSWER:**

The reason for imposing final withholding tax rather than the progressive tax schedule on cash dividends received by a resident citizen or alien from a domestic corporation, is to ensure the collection of income tax on said income. If we subject the dividend to the progressive tax rate, which can only be done through the filing of income tax returns, there is no assurance that the taxpayer will declare the income, especially when there are other items of gross income earned during the year. It would be extremely difficult for the BIR to monitor compliance considering the huge number of stockholders. By shifting the responsibility to remit the tax to the corporation, it is very easy to check compliance because there are fewer withholding agents compared to the number of income recipients.

Likewise, the imposition of a final withholding tax will make the tax available to the government at an earlier time. Finally, the final withholding tax will be a sure revenue to the government unlike when the dividend is treated as a returnable income where the recipient thereof who is in a tax loss position is given the chance to offset such loss against dividend income thereby depriving the government of the tax on said dividend income. [**Note:** *It is recommended that any of the foregoing answers can be given full credit because the question involves a policy issue which can only be found in the deliberations of Congress.*]

**ALTERNATIVE ANSWER:**

The reason why cash dividends received by a resident citizen or alien from a domestic corporation are subjected to the final withholding tax of 10% and not at the progressive rate tax schedule is to lessen the impact of a second layer of tax on the same income.

### Withholding Tax; Income subject thereto (2001)

What is meant by income subject to "final tax"? Give at least two examples of income of resident individuals that is subject to the final tax. (3%)

**SUGGESTED ANSWER:**

Income subject to final tax refers to an income wherein the tax due is fully collected through the withholding tax system. Under this procedure, the payor of the income withholds the tax and remits it to the government as a final settlement of the income tax due on said income. The recipient is no longer required to include the item of income subjected to "final tax" as part of his gross income in his income tax returns. Examples of income subject to final tax are dividend income, interest from bank deposits, royalties, etc.

### Withholding Tax; Non-Resident Alien (1994)

Four Catholic parishes hired the services of Frank Binatra, a foreign non-resident entertainer, to perform for four (4) nights at the Folk Arts Theater. Binatra was paid P200.000.00 a night. The parishes earned P1,000,000.00 which they used for the support of the orphans in the city. Who are liable to pay taxes?

**SUGGESTED ANSWER:**

The following are liable to pay income taxes:

(a) The four catholic parishes because the income received by them, not being income earned "as such" in the performance of their religious functions and duties, is taxable income under the last paragraph of Sec. 26, in relation to Sec. 26(e) of the Tax Code. In

promoting and operating the Binatra Show, they engaged in an activity conducted for profit. (Ibid.)

(b) The income of Frank Binatra, a non-resident alien under our law is taxable at the rate of 30%, final withholding tax based on the gross income from the show. Mr. Binatra is not engaged in any trade or business in the Philippines.

### Withholding Tax; Non-Resident Corporation (1994)

Bates Advertising Company is a non-resident corporation duly organized and existing under the laws of Singapore. It is not doing business and has no office in the Philippines. Pilipinas Garment Incorporated, a domestic corporation, retained the services of Bates to do all the advertising of its products abroad. For said services, Bates' fees are paid through outward remittances. Are the fees received by Bates subject to any withholding tax?

**SUGGESTED ANSWER:**

The fees paid to Bates Advertising Co., a non-resident foreign corporation are not subject to withholding tax since they are not subject to Philippine tax. They are exempt because they do not constitute income from Philippine sources, the same being compensation for labor or personal services performed outside the Philippines (Sec. 36{c) (3) and Sec. 25(b)(l), Tax Code).

### Withholding Tax; Reader's Digest Award (1998)

Is the prize of one million pesos awarded by the Reader's Digest subject to withholding of final tax? Who is responsible for withholding the tax? What are the liabilities for failure to withhold such tax? [5%]

**SUGGESTED ANSWER:**

1) It depends. If the prize is considered as winnings derived from sources within the Philippines, it is subject to withholding of final tax (Sec. 24[B] in relation to Sec. 57[A], NIRC). If derived from sources without the Philippines, it is not subject to withholding of final tax because the Philippine tax law and regulations could not reach out to foreign jurisdictions.

2) The tax shall be withheld by the Reader's Digest or local agent who has control over the payment of the prize.

3) Any person required to withhold or who willfully fails to withhold, shall, in addition to the other penalties provided under the Code, be liable upon conviction to a penalty equal to the total amount of tax not withheld (Sec. 251, NIRC). In case of failure to withhold the tax or in the case of under withholding, the deficiency tax shall be collected from the payor/withholding agent (1st par.. Sec. 2.57[A], R.R. No. 2-98).

Any person required under the Tax Code or by rules and regulations to withhold taxes at the time or times required by law or rules and regulations shall, in addition to other penalties provided by law, upon conviction be punished by a fine of not less than Ten thousand pesos (Php 10.0OO) and suffer imprisonment of not less than one (1) year but not more than ten (10) years (1st par., Sec. 255, NIRC).

**COMMENT:** It is suggested that any of the following answers to the question, "What are the liabilities for failure to withhold such a tax?" be given full credit:

1) The payor shall be liable for the payment of the tax which was not withheld.
2) The payer/withholding agent shall be liable to both civil and criminal penalties imposed by the Tax Code.

### Withholding Tax; Time Deposit Interest; GSIS Pension (1994)

Maribel Santos, a retired public school teacher, relies on her pension from the GSIS and the Interest Income from a time deposit of P500.000.00 with ABC Bank. Is Miss Santos liable to pay any tax on her Income?

**SUGGESTED ANSWER:**

Maribel Santos is exempt from tax on the pension from the GSIS *(Sec. 28(b((7)(F), Tax Code).* However, as regards her time deposit, the interest she receives thereon is subject to 20% final withholding tax. *(Sec. 21(a)(c), Tax Code).*

## DEDUCTIONS, EXEMPTIONS, EXCLUSIONS & INCLUSIONS

### Deduction: Facilitation Fees or "kickback" (1998)

MC Garcia, a contractor who won the bid for the construction of a public highway, claims as expenses, facilitation fees which according to him is standard operating procedure in transactions with the government. Are these expenses allowable as deduction from gross income? [5%]

**SUGGESTED ANSWER:**

No. The alleged facilitation fees which he claims as standard operating procedure in transactions with the government comes in the form of bribes or "kickback" which are not allowed as deductions from gross income *(Section 34(A)(l)(c), NIRC).*

### Deductions: Ordinary Business Expenses (2004)

OXY is the president and chief executive officer of ADD Computers, Inc. When OXY was asked to join the government service as director of a bureau under the Department of Trade and Industry, he took a leave of absence from ADD. Believing that its business outlook, goodwill and opportunities improved with OXY in the government, ADD proposed to obtain a policy of insurance on his life. On ethical grounds, OXY objected to the insurance purchase but ADD purchased the policy anyway. Its annual premium amounted to P100,000. Is said premium deductible by ADD Computers, Inc.? Reason. (5%)

**SUGGESTED ANSWER:**

No. The premium is not deductible because it is not an ordinary business expense. The term "ordinary" is used in the income tax law in its common significance and it has the connotation of being normal, usual or customary ***(Deputy v. Du Pont, 308 US 488 [1940])***. Paying premiums for the insurance of a person not connected to the company is not normal, usual or customary.

Another reason for its non-deductibility is the fact that it can be considered as an illegal compensation made to a government employee. This is so because if the insured, his estate or heirs were made as the beneficiary *(because of the requirement of insurable interest)*, the payment of premium will constitute bribes which are not allowed as deduction from gross income *(Section 34[A][l][c], NIRC).*

On the other hand, if the company was made the beneficiary, whether directly or indirectly, the premium is not allowed as a deduction from gross income *(Section 36[A}14], NIRC).*

### Deductions: Amount for Bribe (2001)

In order to facilitate the processing of its application for a license from a government office, Corporation A found it necessary to pay the amount of Php 100,000 as a bribe to the approving official. Is the Php 100,000 deductible from the gross income of Corporation A? On the other hand, is the Php 100,000 taxable income of the approving official? Explain your answers. (5%)

**SUGGESTED ANSWER:**

Since the amount of Phpl00.000 constitutes a bribe, it is not allowed as a deduction from gross income of Corporation A, *(Section 34(A)(l)(c), NIRC).* However, to the recipient government official, the same constitutes a taxable income. All income from legal or illegal sources are taxable absent any clear provision of law exempting the same. This is the reason why gross income had been defined to include income from whatever source derived. *(Section 32(A), NIRC).* Illegally acquired income constitutes realized income under the claim of right doctrine ***(Rutkin v. US, 343 US 130).***

### Deductions: Capital Losses; Prohibitions (2003)

What is the rationale for the rule prohibiting the deduction of capital losses from ordinary gains? Explain.

**SUGGESTED ANSWER:**

It is to insure that only costs or expenses incurred in earning the income shall be deductible for income tax purposes consonant with the requirement of the law that only necessary expenses are allowed as deductions from gross income. The term "*NECESSARY EXPENSES*" presupposes that in order to be allowed as deduction, the expense must be business connected, which is not the case insofar as capital losses are concerned. This is also the reason why all non-business connected expenses like personal, living and family expenses, are not allowed as deduction from gross income *(Section 36(A)(1) of the 1997 Tax Code).*

The prohibition of deduction of capital losses from ordinary gains is designed to forestall the shifting of deductions from an area subject to lower taxes to an area subject to higher taxes, thereby unnecessarily resulting in leakage of tax revenues. Capital gains are generally taxed at a lower rate to prevent, among others, the bunching of income in one taxable year which is a liberality in the law begotten from motives of public policy *(Rule on Holding Period).* It stands to reason therefore, that if the transaction results in loss, the same should be allowed only from and to the extent of capital gains and not to be deducted from ordinary gains which are subject to a higher rate of income tax. *(Chirelstein, Federal Income Taxation, 1977 Ed.)*

### Deductions: Deductible Items from Gross Income (1999)

Explain if the following items are deductible from gross income for income tax purposes. Disregard who is the person claiming the expense. (5%)

1) Interest on loans used to acquire capital equipment or machinery.
2) Depreciation of goodwill.

**SUGGESTED ANSWER:**

1) ***Interest on loans used to acquire capital equipment or machinery*** is a deductible item from gross income. The law gives the taxpayer the option to claim as a deduction or treat as capital expenditure interest incurred to acquire property used in trade, business or exercise of a profession. *(Section 34(B) (3), NIRC).*

2) ***Depreciation for goodwill*** is not allowed as deduction from gross income. While intangibles maybe allowed to be depreciated or amortized, it is only allowed to those intangibles whose use in the business or trade is definitely limited in duration. (***Basilan Estates, Inc. v, CIR, 21 SCRA 17***). Such is not the case with goodwill.

**ALTERNATIVE ANSWER:**

Depreciation of goodwill is allowed as a deduction from gross income if the goodwill is acquired through capital outlay and is known from experience to be of value to the business for only a limited period. *(Section 107, Revenue Regulations No. 2).* In such case, the goodwill is allowed to be amortized over its useful life to allow the deduction of the current portion of the expense from gross income, thereby paving the way for a proper matching of costs against revenues which is an essential feature of the income tax system.

### Deductions: Income Tax: Donation: Real Property (2002)

On December 06, 2001, LVN Corporation donated a piece of vacant lot situated in Mandaluyong City to an accredited and duly registered non-stock, non-profit educational institution to be used by the latter in building a sports complex for students.

A. May the donor claim in full as deduction from its gross income for the taxable year 2001 the amount of the donated lot equivalent to its fair market value/zonal value at the time of the donation? Explain your answer. (2%)

**SUGGESTED ANSWER:**

A. No. Donations and/or contributions made to qualified donee institutions consisting of property other than money shall be based on the acquisition cost of the property. The donor is not entitled to claim as full deduction the fair market value/zonal value of the lot donated. (Sec. 34(H), NIRC).

B. In order that donations to non-stock, non-profit educational institution may be exempt from the donor's gift tax, what conditions must be met by the donee? (3%)

**SUGGESTED ANSWER:**

B. In order that donations to non-stock, non-profit educational institution may be exempt from the donor's gift tax, it is required that not more than 30% of the said gifts shall be used by the donee-institution for administration purposes. (Sec. 101(A)(3), NIRC).

### Deductions: Non-Deductible Items; Gross Income (1999)

Explain if the following items are deductible from gross income for income tax purposes. Disregard who is the person claiming the deduction. (5%)

1. Reserves for bad debts.
2. Worthless securities

**SUGGESTED ANSWER:**

1. **RESERVE FOR BAD DEBTS** are not allowed as deduction from gross income. Bad debts must be charged off during the taxable year to be allowed as deduction from gross income. The mere setting up of reserves will not give rise to any deduction. (Section 34(E). NTRC).

2. **WORTHLESS SECURITIES**, which are ordinary assets, are not allowed as deduction from gross income because the loss is not realized. However, if these worthless securities are capital assets, the owner is considered to have incurred a capital loss as of the last day of the taxable year and, therefore, deductible to the extent of capital gains. *(Section 34(D)(4), NIRC).* This deduction, however, is not allowed to a bank or trust company. *(Section 34(E)(2), NIRC).*

### Deductions: Requisites; Deducibility of a Loss (1998)

Give the requisites for deducibility of a loss. (5%1

**SUGGESTED ANSWER:**

The requisites for deducibility of a loss are

1) loss belongs to the taxpayer;
2) actually sustained and charged off during the taxable year;
3) evidenced by a closed and completed transaction;
4) not compensated by Insurance or other forms of indemnity;
5) not claimed as a deduction for estate tax purposes in case of individual taxpayers; and
6) if it is a casualty loss it is evidenced by a declaration of loss filed within 45 days with the BIR.

**COMMENT:**

The question is vague. There are different kinds of losses recognized as deductible under the Tax Code. These are losses, in general (Sec. 34[D](1); net operating loss carryover (Sec. 34[D](3); capital losses (Sec. 34[D](4); Losses from wash sales of stocks or securities (Sec. 34[D](5) in relation to Sec. 38); wagering losses (Sec. 34[D](6); and abandonment losses (Sec. 34(D](7). Losses are also deductible from the gross estate (Sec. 86[A](l)(e), NIRC).

Considering the time allotted for a five (5) point question is only nine (9) minutes, the candidates would not be able to write down a complete answer. It is suggested that any answer which states the requisites for the deducibility of any of the above losses be given full credit.

### Deductions; Income Tax: Allowable Deductions (2001)

Taxpayers whose only income consists of salaries and wages from their employers have long been complaining that they are not allowed to deduct any item from their gross income for purposes of computing their net taxable income. With the passage of the Comprehensive Tax Reform Act of 1997, is this complaint still valid? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No more. Gross compensation income earners are now allowed at least an item of deduction in the form of premium payments on health and/or hospitalization insurance in an amount not exceeding P2,400 per annum [Section 34(M)]. This deduction is allowed if the aggregate family income do not exceed P250.000 and by the spouse, in case of married individual, who claims additional personal exemption for dependents.

### Deductions; Vanishing Deduction; Purpose (2006)

Vanishing deduction is availed of by taxpayers to:

a. Correct his accounting records to reflect the actual deductions made
b. Reduce his gross income
c. Reduce his output value-added tax liability
d. Reduce his gross estate

Choose the correct answer. Explain. (5%)

**SUGGESTED ANSWER:**

(D) reduce his gross estate. Vanishing deduction or property previously taxed is one of the items of deduction allowed in computing the net estate of a decedent *(Section 86[A][2] and 86[B][2], NIRC).*

### Exclusion & Inclusion; Gross Receipts (2006)

Congress enacts a law imposing a 5% tax on gross receipts of common carriers. The law does not define the term "gross receipts." Express Transport, Inc., a bus company plying the Manila-Baguio route, has time deposits with ABC Bank. In 2005, Express Transport earned P1 Million interest, after deducting the 20% final withholding tax from its time deposits with the bank. The BIR wants to collect a 5% gross receipts tax on the interest income of Express Transport without deducting the 20% final withholding tax. Is the BIR correct? Explain. (5%)

**ALTERNATIVE ANSWER:**

Yes. The term "Gross Receipts" is broad enough to include income constructively received by the taxpayer. The amount withheld is paid to the government on its behalf, in satisfaction of withholding taxes. The fact that it did not actually receive the amount does not alter the fact that it is remitted in satisfaction of its tax obligations. Since the income withheld is an income owned by Express Transport, the same forms part of its gross receipts ***(CIR v. Solidbank Corp., G.R. No. 148191, November 25, 2003).***

**ALTERNATIVE ANSWER:**

No. The term "gross receipts," as applied to the business of a common carrier consists of revenues from carriage of goods, cargoes, and passengers. It does not comprehend or include interest income which is properly described as "Other Income."

*(**NOTA BENE**: This question pertains to a percentage tax on Gross Receipts which is excluded from the Bar coverage)*

### Exclusion vs. Deduction from Gross Income (2001)

Distinguish "Exclusion from Gross Income" from "Deductions From Gross Income". Give an example of each. (2%)

**SUGGESTED ANSWER:**

***EXCLUSIONS from gross income*** refer to a flow of wealth to the taxpayer which are not treated as part of gross income, for purposes of computing the taxpayer's taxable income, due to the following reasons: (1) It is exempted by the fundamental law; (2) It is exempted by statute; and (3) It does not come within the definition of income. (Section 61, RR No. 2). ***DEDUCTIONS from gross income***, on the other hand, are the amounts, which the law allows to be deducted from gross income in order to arrive at net income.

Exclusions pertain to the computation of gross income, while deductions pertain to the computation of net income. Exclusions are something received or earned by the taxpayer which do not form part of gross income while deductions are something spent or paid in earning gross income.

Example of an exclusion from gross income is proceeds of life insurance received by the beneficiary upon the death of the insured which is not an income or 13th month pay of an employee not exceeding P30.000 which is an income not recognized for tax purposes. Example of a deduction is business rental.

### Exclusions & Inclusions: Benefits on Account of Injury (1995)

Mr. Infante was hit by a wayward bus while on his way to work. He survived but had to pay P400.000.00 for his hospitalization. He was unable to work for six months which meant that he did not receive his usual salary of P 10,000.00 a month or a total of P60.000.00. He sued the bus company and was able to obtain a final judgment awarding him P400.000.00 as reimbursement for his hospitalization, P60.000 for the salaries he failed to receive while hospitalized, P200,000.00 as moral damages for his pain and suffering, and P 100,000.00 as exemplary damages. He was able to collect in full from the judgment. How much income did he realize when he collected on the judgment? Explain.

**SUGGESTED ANSWER:**

None. The P200.000 moral and exemplary damages are compensation for injuries sustained by Mr. Infante. The P400.000.00 reimbursement for hospitalization expenses and the P60.000.00 for salaries he failed to receive are 'amounts of any damages received whether by suit or agreement on account of such injuries.' Section 28(b)(5) of the Tax Code specifically exclude these amounts from the gross income of the individual injured. (Section 28(b), NIRC and Sec. 63 Rev. Reg. No. 2)

**ALTERNATIVE ANSWER:**

The income realized from the judgment is only the recovery for lost salaries. This constitutes taxable income because were it not for the injury, he could have received it from his employer as compensation income. All the other amounts received are either compensation for injuries or damages received on account of such injuries' which are exclusions from gross income pursuant to Section 28(b)(5) of the Tax Code.

### Exclusions & Inclusions: Executive Benefits (1995)

Mr. Adrian is an executive of a big business corporation. Aside from his salary, his employer provides him with the following benefits: free use of a residential house in an exclusive subdivision, free use of a limousine and membership in a country club where he can entertain customers of the corporation. Which of these benefits, if any, must Mr. Adrian report as income? Explain.

**SUGGESTED ANSWER:**

Mr. Adrian must report the imputed rental value of the house and limousine as income. If the rental value exceeds the personal needs of Mr. Adrian because he is expected to provide accommodation in said house for company guests or the car is used partly for business purpose, then Mr. Adrian is entitled only to a ratable rental value of the house and limousine as exclusion from gross income and only a reasonable amount should be reported as income. This is because the free housing and use of the limousine are given partly for the convenience and benefit of the employer ***(Collector vs. Henderson).***

**ALTERNATIVE ANSWER:**

Remuneration for services although not given in the form of cash constitutes compensation income. Accordingly, the value for the use of the residential house is part of his compensation income which he must report for income tax purposes. However, if the residential house given to Mr. Adrian for his free use as an executive is also used for the benefit of the corporation/employer, such as for entertaining customers of the corporation, only 50% of the rental value or depreciation (if the house is owned by the corporation) shall form part of compensation income (RAMO 1-87).

The free use of a limousine and the membership in a country club is not part of Mr. Adrian's compensation income because they were given for the benefit of the employer and are considered to be necessary incidents for the proper performance of his duties as an executive of the corporation.

The membership fee in the country club needs to be reported as income. It appears that the membership of Mr. Adrian to the country club is primarily for the benefit and convenience of the employer. This is to enable Mr. Adrian to entertain company guests ***(Collector vs. Henderson).***

### Exclusions & Inclusions; Assets; Resident Alien (2005)

Ralph Donald, an American citizen, was a top executive of a U.S. company in the Philippines until he retired in 1999. He came to like the Philippines so much that following his retirement, he decided to spend the rest of his life in the country. He applied for and was granted a permanent resident status the following year. In the spring of 2004, while vacationing in Orlando, Florida, USA, he suffered a heart attack and died. At the time of his death, he left the following properties: (a) bank deposits with Citibank Makati and Citibank Orlando, Florida; (b) a resthouse in Orlando, Florida; (c) a condominium unit in

Makati; (d) shares of stock in the Philippine subsidiary of the U.S. Company where he worked; (e) shares of stock in San Miguel Corp. and PLOT; (f) shares of stock in Disney World in Florida; (g) U.S. treasury bonds; and (g) proceeds from a life insurance policy issued by a U.S. corporation.

Which of the foregoing assets shall be included in the taxable gross estate in the Philippines? Explain. (5%)

**SUGGESTED ANSWER:**

All of the properties enumerated except (g), the proceeds from life insurance, are included in the taxable gross estate in the Philippines. Ralph Donald is considered a resident alien for tax purposes since he is an American Citizen and was a permanent resident of the Philippines at the time of his death. The value of the gross estate of a resident alien decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated. (Sec. 85, NIRC)

The other item, (g) proceeds from a life insurance policy, may also be included on the assumption that it was Ralph Donald who took out the insurance upon his own life, payable upon his death to his estate. (Sec. 85[E], NIRC)

### Exclusions & Inclusions; Benefits on Account of Death (1996)

X, an employee of ABC Corporation died. ABC Corporation gave X's widow an amount equivalent to X's salary for one year. Is the amount considered taxable income to the widow? Why?

**SUGGESTED ANSWER:**

No. The amount received by the widow from the decedent's employer may either be a gift or a separation benefit on account of death. Both are exclusions from gross income pursuant to provisions of Section 28(b) of the Tax Code.

**ALTERNATIVE ANSWER:**

No. Since the amount was given to the widow and not to the estate, it becomes obvious that the amount is more of a gift. In one U.S. tax case (***Estate of Hellstrom vs. Commissioner, 24 T.C. 916***), it was held that payments to the widow of the president of a corporation of the amount the president would have received in salary if he lived out the year constituted a gift and not an income.

The controlling facts which would lead to the conclusion that the amount received by the widow is not an income are as follows:

7) the gift was made to the widow rather than the estate:
8) there was no obligation for the corporation to make further payments to the deceased;
9) the widow had never worked for the corporation;
10) the corporation received no economic benefit; and
11) the deceased had been fully compensated for his services (***Estate of Sydney Carter vs. Commissioner, 453 F. 2d 61 (2dCir. 1971***).

### Exclusions & Inclusions; Benefits on Account of Injury (2005)

JR was a passenger of an airline that crashed. He survived the accident but sustained serious physical injuries which required hospitalization for 3 months. Following negotiations with the airline and its insurer, an agreement was reached under the terms of which JR was paid the following amounts: P500,000.00 for his hospitalization; P250,000.00 as moral damages; and P300,000.00 for loss of income during the period of his treatment and recuperation. In addition, JR received from his employer the amount of P200,000.00 representing the cash equivalent of his earned vacation and sick leaves.

Which, if any, of the amounts he received are subject to income tax? Explain. (5%)

**SUGGESTED ANSWER:**

All amounts received from the airline company are excluded from gross income. Under Sec. 32(B)(4) of the NIRC, amounts of damages received, whether by suit or agreement, on account of personal injuries or sickness are excluded from gross income. Since the amounts received from the airline company were received as damages by agreement on account of personal injuries, all shall be excluded from JR's gross income.

The amount of P200,000.00, less the equivalent of not more than 10 days of vacation leave, received by JR from his employer, is subject to income tax under Sec. 2.78.1 (a) (7) of R.R. No. 2-98.

### Exclusions & Inclusions; Compensation for personal injuries or sickness (2003)

X, while driving home from his office, was seriously injured when his automobile was bumped from behind by a bus driven by a reckless driver. As a result, he had to pay P200,000.00 to his doctor and P100, 000.00 to the hospital where he was confined for treatment. He filed a suit against the bus driver and the bus company and was awarded and paid actual damages of P300, 000.00 *(for his doctor and hospitalization bills),* P100,000.00 by way of moral damages, and P50,000.00 for what he had to pay his attorney for bringing his case to court. Which, if any, of the foregoing awards are taxable income to X and which are not? Explain. (8%)

**SUGGESTED ANSWER:**

Nothing is taxable. Under the Tax Code, any amount received as compensation for personal injuries or sickness, plus the amounts for any damages received whether by suit or agreement, on account of such injuries or sickness shall be excluded from gross income. Since the entire amount of P450, 000.00 received are award of damages on account of the injuries sustained; all shall be excluded from his gross income. Obviously, these damages are considered by law as mere return of capital. (Section 32(B)(4), 1997 Tax Code)

### Exclusions & Inclusions; Facilities or Privileges; Military Camp (1995)

Capt. Canuto is a member of the Armed Forces of the Philippines. Aside from his pay as captain, the government gives him free uniforms, free living quarters in whatever military camp he is assigned, and free meals inside the camp. Are these benefits income to Capt. Canuto? Explain.

**SUGGESTED ANSWER:**

No, the free uniforms, free living quarters and the free meals inside the camp are not income to Capt. Canute because these are facilities or privileges furnished by the

employer for the employer's convenience which are necessary incidents to proper performance of the military personnel's duties.

### Exclusions & Inclusions; Gifts over and above the Retirement Pay (1995)

Mr. Quiroz worked as chief accountant of a hospital for forty-five years. When he retired at 65 he received retirement pay equivalent to two months' salary for every year of service as provided in the hospital BIR approved retirement plan. The Board of Directors of the hospital felt that the hospital should give Quiroz more than what was provided for in the hospital's retirement plan in view of his loyalty and invaluable services for forty-five years; hence, it resolved to pay him a gratuity of P1 Million over and above his retirement pay.

The Commissioner of Internal Revenue taxed the P1 Million as part of the gross compensation income of Quiroz who protested that it was excluded from income because (a) it was a retirement pay, and (b) it was a gift.

1) Is Mr. Quiroz correct in claiming that the additional P1 Million was retirement pay and therefore excluded from income? Explain.
2) Is Mr. Quiroz correct in claiming that the additional P1 Million was gift and therefore excluded from income? Explain.

**SUGGESTED ANSWERS:**

1) No. The additional P1 million is not a retirement pay but a part of the gross compensation income of Mr. Quiroz. This is not a retirement benefit received in accordance with a reasonable private benefit plan maintained by the employer as it was not paid out of the retirement plan. Accordingly, the amount received in excess of the retirement benefits that he is entitled to receive under the BIR-approved retirement plan would not qualify as an exclusion from gross income.

2) No. The amount received was in consideration of his loyalty and invaluable services to the company which is clearly a compensation income received on account of employment. Under the employer's 'motivation test,' emphasis should be placed on the value of Mr. Quiroz services to the company as the compelling reason for giving him the gratuity, hence it should constitute a taxable income. The payment would only qualify as a gift if there is nothing but 'good will, esteem and kindness' which motivated the employer to give the gratuity. ***(Stonton vs. U.S., 186 F. Supp. 393).*** Such is not the case in the herein problem.

**ALTERNATIVE ANSWER:**

Yes. The 1 million is not compensation income subject to income tax but a gift from his employer. There was no evidence presented to show that he was not fully compensated for his 45 years of service. If his services contributed in a large measure to the success of the hospital, it did not give rise to a recoverable debt. The P1 million is purely a gratuity from the company. It is a taxable gift to the transferor. Under the Tax Code, gifts are excluded from gross income therefore exempt from income tax. (Sec. 28{b)(3), NIRC; ***Pirovano vs. Commissioner***)

### Exclusions & Inclusions; ITR; 13th month pay and de minimis benefits (2005)

State with reasons the tax treatment of the following in the preparation of annual income tax returns: 13th month pay and *de minimis* benefits;

**SUGGESTED ANSWER:**

The ***13th month pay*** not exceeding P30,000.00 shall not be reported in the income tax return because it is excluded from gross income (*Sec. 32[B][7], [e], NIRC*) The amount of the 13th month pay in excess of P30,000.00 shall be reported in the annual income tax return.

***De minimis benefits*** which do not exceed the ceilings are excluded from gross income, and not to be considered for determining the P30,000.00 ceiling hence not reportable in the annual income tax return. *(Sec. 2.78.1[A][3], R.R. 2-98 as amended by Sec. 2.33 [C] and further amended by R.R. No. 8-2000)*

### Exclusions & Inclusions; ITR; Dividends received by a domestic corporation (2005)

State with reasons the tax treatment of the following in the preparation of annual income tax returns: Dividends received by a domestic corporation from (i) another domestic corporation; and (ii) a foreign corporation;

**SUGGESTED ANSWER:**

(i) Dividends received by a domestic corporation from a domestic corporation shall not be subject to tax (Sec. 27[D][4], NIRC), hence, excluded from the income tax return.

(ii) Dividends received by a domestic corporation from a foreign corporation form part of the gross income and are accordingly subject to net income tax, hence included in the annual ITR (Sec. 42[A][2][b], NIRC), hence, must be included in the income tax return.

### Exclusions & Inclusions; ITR; Income realized from sale (2005)

State with reasons the tax treatment of the following in the preparation of annual income tax returns: Income realized from sale of: (i) capital assets; and (ii) ordinary assets.

**SUGGESTED ANSWER:**

(i) Income realized from sale of capital assets is subject to the final withholding tax at source and therefore excluded from the Income Tax Return (Sec. 24[C] and [D], NIRC);

(ii) Income realized from sale of ordinary assets is part of Gross Income, included in the Income Tax Return. (Sec. 32[A][3], NIRC)

### Exclusions & Inclusions; ITR; Interest on deposits (2005)

State with reasons the tax treatment of the following in the preparation of annual income tax returns: Interest on deposits with: (i) BPI Family Bank; and (ii) a local offshore banking unit of a foreign bank;

**SUGGESTED ANSWER:**

Both items are excluded from the income tax return:

(i) Interest income from any currency bank deposit is considered passive income from sources within the Philippines and subject to final tax. Since it is subject to

final tax it is not to be included in the annual ITR. (Sec. 24[B][1], NIRC) (u) Same as No. (j).

### Exclusions & Inclusions; ITR; Proceeds of life insurance (2005)

State with reasons the tax treatment of the following in the preparation of annual income tax returns: Proceeds of life insurance received by a child as irrevocable beneficiary;

**SUGGESTED ANSWER:**

Not to be reported in the annual income tax returns because the proceeds of the life insurance are excluded from gross income. Proceeds of Life insurance policies paid to the heirs or beneficiaries
upon the death of the insured is an exclusion from gross income. *(Sec.32[B][I],NIRC)*

### Exclusions & Inclusions; Life Insurance Policy (2003)

On 30 June 2000, X took out a life insurance policy on his own life in the amount of P2,000,000.00. He designated his wife, Y, as irrevocable beneficiary to P1,000,000.00 and his son, Z, to the balance of P1,000,000.00 but, in the latter designation, reserving his right to substitute him for another. On 01 September 2003, X died and his wife and son went to the insurer to collect the proceeds of X's life insurance policy. (8%)

(a) Are the proceeds of the insurance subject to income tax on the part of Y and Z for their respective shares? Explain.

(b) Are the proceeds of the insurance to form part of the gross estate of X? Explain.

**SUGGESTED ANSWERS:**

(a) No. The law explicitly provides that proceeds of life insurance policies paid to the heirs or beneficiaries upon the death of the insured are excluded from gross income and is exempt from taxation. The proceeds of life insurance received upon the death of the insured constitute a compensation for the loss of life, hence a return of capital, which is beyond the scope of income taxation. *(Section 32(B)(1) 1997 Tax Code)*

(b) Only the proceeds of P1,000,000.00 given to the son, Z, shall form part of the Gross Estate of X. Under the Tax Code, proceeds of life insurance shall form part of the gross estate of the decedent to the extent of the amount receivable by the beneficiary designated in the policy of the insurance except when it is expressly stipulated that the designation of the beneficiary is irrevocable. As stated in the problem, only the designation of Y is irrevocable while the insured/decedent reserved the right to substitute Z as beneficiary for another person. Accordingly, the proceeds received by Y shall be excluded while the proceeds received by Z shall be included in the gross estate of X. *(Sect/on 85(E), 1997 Tax Code)*

### Exemptions: Charitable Institutions (2000)

Article VI, Section 28 (3) of the 1987 Philippine Constitution provides that charitable institutions, churches and personages or covenants appurtenant thereto, mosques, non-profit cemeteries and all lands, buildings and improvements actually, directly and exclusively used for religious, charitable or educational purposes shall be exempt from taxation.

a) To what kind of tax does this exemption apply? (2%)

**SUGGESTED ANSWER:**

This exemption applies only to property taxes. What is exempted is not the institution itself but the lands, buildings and improvements actually, directly and exclusively used for religious, charitable and educational purposes. ***(Commissioner of Internal Revenue v. Court of Appeals, et al, G.R. No. 124043, October 14, 1998).***

b) Is proof of actual use necessary for tax exemption purposes under the Constitution? (3%)

**SUGGESTED ANSWER:**

Yes, because tax exemptions are strictly construed against the taxpayer. There must be evidence to show that the taxpayer has complied with the requirements for exemption. Furthermore, real property taxation is based on use and not on ownership, hence the same rule must also be applied for real property tax exemptions.

### Exemptions: Charitable Institutions; Churches (1996)

The Constitution exempts from taxation charitable institutions, churches, parsonages or convents appurtenant thereto, mosques arid non-profit cemeteries and lands, buildings and improvements actually, directly and exclusively used for religious, charitable and educational purposes. Mercy Hospital is a 100-bed hospital organized for charity patients. Can said hospital claim exemption from taxation under the above-quoted constitutional provision? Explain.

**SUGGESTED ANSWER:**

Yes. Mercy Hospital can claim exemption from taxation under the provision of the Constitution, but only with respect to real property taxes provided that such real properties are used actually, directly and exclusively for charitable purposes.

### Exemptions: Educational institution (2004)

Suppose that XYZ Colleges is a proprietary educational institution owned by the Archbishop's family, rather than the Archdiocese, which of those above cited income and donation would be exempt from taxation? Explain briefly. (5%)

**SUGGESTED ANSWER:**

If XYZ Colleges is a proprietary educational institution, all of its income from school related and non-school related activities will be subject to the income tax based on its aggregate net income derived from both activities (Section 27(B), NMC). Accordingly, all of the income enumerated in the problem will be taxable.

The donation of lot and building will likewise be subject to the donor's tax because a donation to an educational institution is exempt only if the school is incorporated as a non-stock entity paying no dividends.

Since the donee is a proprietary educational institution, the donation is taxable (Section 101(AX3), NJRC).

### Exemptions: Gifts & Donations (1994)

In 1991, Imelda gave her parents a Christmas gift of P 100,000.00 and a donation of P50,000.00 to her parish

church. She also donated a parcel of land for the construction of a building to the PUP Alumni Association, a non-stock, non-profit organization. Portions of the building shall be leased to generate income for the association.

1) Is the Christmas gift of P 100,000.00 to Imelda's parents subject to tax?
2) How about the donation to the parish church?
3) How about the donation to the P.U.P, Alumni Association?

**SUGGESTED ANSWER:**

1) The Christmas gift of P100,000.00 given by Imelda to her parents is taxable up to P50,000.00 because under the law *(Sec. 92 (a) of the Tax Code),* net gifts not exceeding P50,000.00 are exempt.

***2)*** The donation of P50,000.00 to the parish church even assuming that it is exclusively for religious purposes is not tax-exempt because the exemption granted under Article VI, Sec. 28(3) of the Constitution applies only to real estate taxes ***(Lladoc v. Commissioner, 14SCRA292).***

3) The donation to the P.U.P. Alumni Association does not also qualify for exemption both under the Constitution and the aforecited law because it is not an educational or research organization, corporation, institution, foundation or trust.

**ALTERNATIVE ANSWER:**

Donation to the P.U.P. Alumni Association is exempt from donor's tax if it is proven that the association is a nonstock, non-profit charitable association, paying no dividends, governed by trustees who receive no compensation, and devoting all its income to the accomplishment and promotion of the purposes enumerated in its articles of incorporation. Not more than 30% of the gift should be used for administration purposes by the donee.

### Exemptions: Head of the Family: (1998)

Arnold, who is single, cohabits with Vilma, who is legally married to Zachary. Arnold and Vilma have six minor children who live and depend upon Arnold for their chief support. The children are not married and not gainfully employed.

1) For income tax purposes, may Arnold be considered as "head of a family?" [3%]
2) Is Arnold entitled to deduct from his gross income, an additional exemption for each of his illegitimate child? [2%]

**SUGGESTED ANSWER:**

*1)* Yes. An unmarried man who has illegitimate minor children who live with him and depend upon him for their chief support is considered as "head of the family" (*RR No. 2-98 implementing Section 35, NIRC).*

2) No. Arnold is only entitled to deduct additional personal exemption for four (4) out of the six (6) illegitimate children. The maximum number of dependents for purposes of the additional personal exemption is four. (Sec. 35, NIRC).

### Exemptions: Non-Profit Educational Institutions (2000)

Under Article XTV, Section 4 (3) of the 1987 Philippine Constitution, all revenues and assets of non-stock, nonprofit educational institutions, used actually, directly and exclusively for educational purposes, are exempt from taxes and duties. Are income derived from dormitories, canteens and bookstores as well as interest income on bank deposits and yields from deposit substitutes automatically exempt from taxation? Explain. (5%)

**SUGGESTED ANSWER:**

No. The interest income on bank deposits and yields from deposit substitutes are not automatically exempt from taxation. There must be a showing that the incomes are included in the school's annual information return and duly audited financial statements together with:

1. Certifications from depository banks as to the amount of interest income earned from passive investments not subject to the 20% final withholding tax;
2. Certification of actual, direct and exclusive utilization of said income for educational purposes;
3. Board resolution on proposed project to be funded out of the money deposited in banks or placed in money market placements *(Finance Department Order No. 149-95 issued November 24, 1995),* which must be used actually, directly and exclusively for educational purposes.

The income derived from dormitories, canteens and bookstores are not also automatically exempt from taxation. There is still the requirement for evidence to show actual, direct and exclusive use for educational purposes. It is to be noted that the 1987 Philippine Constitution does not distinguish with respect to the source or origin of the income. The distinction is with respect to the use which should be actual, direct and exclusive for educational purposes.

Consequently, the provisions of Sec. 30 of the NIRC of 1997, that a non-stock and nonprofit educational institution is exempt from taxation only "in respect to income received by them as such" could not affect the constitutional tax exemption. Where the Constitution does not distinguish with respect to source or origin, the Tax Code should not make distinctions.

### Exemptions: Non-Profit Entity; Ancillary Activity & Incidental Operations (1994)

The University of Bigaa, a non-stock, non-profit entity, operates a canteen for its students and a bookstore inside the campus. It also operates two dormitories for its students, one of which is in the campus. Is the University liable to pay income taxes for the operation of the: 1) canteen? 2) bookstore? 3) two dormitories?

**SUGGESTED ANSWER:**

1) For the operation of the canteen inside the campus, the income thereon being incidental to the operations of the University as a school, is exempt *(Art. XIV (4) (3), Constitution; DECS Regulations No. 137-87, Dec. 16, 1987).*

2) For the same reasons, the University of Bigaa is not liable to pay income taxes for the operation of the

bookstore, since this is an ancillary activity the conduct of which is carried out within the school premises.

3) The University of Bigaa shall not be liable to pay income taxes for the operation of the dormitory located in the campus, for same reasons as the foregoing. However, the latter shall be liable for income taxes on income from operations of the dormitory located outside the school premises.

### Exemptions: Non-Stock/ Non-Profit Association (2002)

XYZ Foundation is a non-stock, non-profit association duly organized for religious, charitable and social welfare purposes. Last January 3, 2000 it sold a portion of its lot used for religious purposes and utilized the entire proceeds for the construction of a building to house its free Day and Night Care Center for children of single parents. In order to subsidize the expenses of the Day and Night Care Center and to support its religious, charitable and social welfare projects, the Foundation leased the 300-square meter area of the second and third floors of the building for use as a boarding house. The Foundation also operates a canteen and a gift shop within the premises, all the income from which is used actually, directly, and exclusively for the purposes for which the Foundation was organized.

A. Considering the constitutional provision granting tax exemption to non-stock corporations such as those formed exclusively for religious, charitable or social welfare purposes, explain the meaning of the last paragraph of said Sec. 30 of the 1997 Tax Code which states that *"Income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income shall be subject to tax imposed under this Code."* (5%)

**SUGGESTED ANSWER:**

A. The exemption contemplated in the Constitution covers real estate tax on real properties actually, directly and exclusively used for religious, charitable or social welfare purposes. It does not cover exemption from the imposition of the income tax which is within the context of Section 30 of the Tax Code. As a rule, non-stock non-profit corporations organized for religious, charitable or social welfare purposes are exempt from income tax on their income received by them as such. However, if these religious, charitable or social welfare corporations derive income from their properties or any of their activities conducted for profit, the income tax shall be imposed on said items of income irrespective of their disposition. (***Sec. 30, NIRC; CIR v, YMCA, GR No. 124043, 1998***).

B. Is the income derived by XYZ Foundation from the sale of a portion of its lot, rentals from its boarding house and the operation of its canteen and gift shop subject to tax? Explain. (5%)

**SUGGESTED ANSWER:**

B. Yes. The income derived from the sale of lot and rentals from its boarding house are considered as income from properties which are subject to tax. Likewise, the income from the operation of the canteen and gift shop are income from its activities conducted for profit which are subject to tax. The income tax attaches irrespective of the disposition of these incomes. (***Sec. 30, NIRC; CIR v. YMCA, GR No. 124043, 1998***).

### Exemptions: Prize of Peace Poster Contest (2000)

Jose Miranda, a young artist and designer, received a prize of P100,000.00 for winning in the on-the-spot peace poster contest sponsored by a local Lions Club. Shall the reward be included in the gross income of the recipient for tax purposes? Explain. (3%)

**SUGGESTED ANSWER:**

No. It is not includable in the gross income of the recipient because the same is subject to a final tax of 20%, the amount thereof being in excess of P10.000 *(Sec. 24(B){1), NIRC of 1997).* The prize constitutes a taxable income because it was made primarily in recognition of artistic achievement which he won due to an action on his part to enter the contest. *[Sec. 32 (B) (7) (c), NIRC of 1997]* Since it is an on-the-spot contest, it is evident that he must have joined the contest in order to earn the prize or award.

### Exemptions: Prizes & Awards; Athletes (1996)

Onyoc, an amateur boxer, won in a boxing competition sponsored by the Gold Cup Boxing Council, a sports association duly accredited by the Philippine Boxing Association. Onyoc received the amount of P500,000 as his prize which was donated by Ayala Land Corporation. The BIR tried to collect income tax on the amount received by Onyoc and donor's tax from Ayala Land Corporation, which taxes, Onyoc and Ayala Land Corporation refuse to pay. Decide.

**SUGGESTED ANSWER:**

The prize will not constitute a taxable income to Onyoc, hence the BIR is not correct in imposing the income tax. R.A. No. 7549 explicitly provides that 'All prizes and awards granted to athletes in local and international sports tournaments and competitions held in the Philippines or abroad and sanctioned by their respective national sports associations shall be exempt from income tax".

Neither is the BIR correct in collecting the donor's tax from Ayala Land Corporation. The law is clear when it categorically stated "That the donor's of said prizes and awards shall be exempt from the payment of the donor's tax."

### Exemptions: Retirement Benefits: Work Separation (1999)

A Co., a Philippine corporation, has two divisions — manufacturing and construction. Due to the economic situation, it had to close its construction division and lay-off the employees in that division. A Co. has a retirement plan approved by the BIR, which requires a minimum of 50 years of age and 10 years of service in the same employer at the time of retirement. There are 2 groups of employees to be laid off:

1) Employees who are at least 50 years of age and has at 10 years of service at the time of termination of employment.
2) Employees who do no meet either the age or length of service A Co. plans to give the following:

a. For category (A) employees - the benefits under the BIR approved plan plus an ex gratia payment of one month of every year of service.
b. For category (B) employees - one month for every year of service.

For both categories, the cash equivalent of unused vacation and sick leave credits.

A Co. seeks your advice as to whether or not it will subject any of these payments to WT. Explain your advice. (5%)

**SUGGESTED ANSWER:**

For category **A** employees, all the benefits received on account of their separation are not subject to income tax, hence no withholding tax shall be imposed. The benefits received under the BIR-approved plan upon meeting the service requirement and age requirement are explicitly excluded from gross income. The ex gratia payment also qualifies as an exclusion from gross income being in the nature of benefit received on account of separation due to causes beyond the employees' control. (Section 32(B), NIRC). The cash equivalent of unused vacation and sick leave credits qualifies as part of separation benefits excluded from gross income (***CIR v. Court of Appeals, GR No. 96O16, October 17, 1991***).

For category B employees, all the benefits received by them will also be exempt from income tax, hence not subject to withholding tax. These are benefits received on account of separation due to causes beyond the employees' control, which are specifically excluded from gross income. *(Section 32(B), NIRC).*

**ALTERNATIVE ANSWER;**

All of the payments are not subject to income tax and should not also be subject to withholding tax. The employees were laid off, hence separated for a cause beyond their control. Consequently, the amounts to be paid by reason of such involuntary separation are excluded from gross income, irrespective of whether the employee at the time of separation has rendered less than ten years of service and/or is below fifty years of age. *(Section 32(B), NIRC).*

### Exemptions: Separation Pay (1994)

Pedro Reyes, an official of Corporation X, asked for an "earlier retirement" because he was emigrating to Australia. He was paid P2.000.000.00 as separation pay in recognition of his valuable services to the corporation.

Juan Cruz, another official of the same company, was separated for occupying a redundant position. He was given P1,000.000.00 as separation pay.

Jose Bautista was separated due to his failing eyesight. He was given P500.000.00 as separation pay.

All the three (3) were not qualified to retire under the BIR-approved pension plan of the corporation.

1) Is the separation pay given to Reyes subject to income tax?
2) How about the separation pay received by Cruz?
3) How about the separation pay received by Bautista?

**SUGGESTED ANSWER:**

1) The separation pay given to Reyes is subject to income tax as compensation income because it arises from a service rendered pursuant to an employer-employee relationship. It is not considered an exclusion from gross income because the rule in taxation is tax construed in *strictissimi juris* or the rule on strict Interpretation of tax exemptions.

2) The separation pay received by Cruz is not subject to income tax because his separation from the company was involuntary (Sec. 28 b (7), Tax Code).

3) The separation pay received by Bautista is likewise not subject to tax. His separation is due to disability, hence involuntary. Under the law, separation pay received through involuntary causes are exempt from taxation.

### Exemptions: Separation Pay (1995)

Mr. Jacobo worked for a manufacturing firm. Due to business reverses the firm offered voluntary redundancy program in order to reduce overhead expenses. Under the program an employee who offered to resign would be given separation pay equivalent to his three month's basic salary for every year of service. Mr. Jacobo accepted the offer and received P400.000.00 as separation pay under the program.

After all the employees who accepted the offer were paid, the firm found its overhead still excessive. Hence it adopted another redundancy program. Various unprofitable departments were closed. As a result, Mr. Kintanar was separated from the service. He also received P400.000.00 as separation pay.

1) Did Mr. Jacobo derive income when he received his separation pay? Explain.
2) Did Mr. Kintanar derive income when he received his separation pay? Explain.

**SUGGESTED ANSWER:**

1) Yes, Mr. Jacobo derived a taxable income when he received his separation pay because his separation from employment was voluntary on his part in view of his offer to resign. What is excluded from gross income is any amount received by an official or employee as a consequence of separation of such official or employee from the service of the employer for any cause beyond the control of the said official or employee (Sec 28, NIRC).

**ALTERNATIVE ANSWER:**

No, Mr. Jacobo did not derive any taxable income because the separation pay was due to a retrenchment policy adopted by the company so that any employee terminated by virtue thereof is considered to have been separated due to causes beyond the employee's control. The voluntary redundancy program requiring employees to make an offer to resign is only considered as a tool to expedite the lay-off of excess manpower whose services are no longer needed by the employer, but is not the main reason or cause for the termination

**SUGGESTED ANSWER:**

2) No, Mr. Kintanar did not derive any income when he received his separation pay because his separation from

employment is due to causes beyond his control. The separation was involuntary as it was a consequence of the closure of various unprofitable departments pursuant to the redundancy program.

### Exemptions: Separation Pay (2005)

Company A decides to close its operations due to continuing losses and to terminate the services of its employees. Under the Labor Code, employees who are separated from service for such cause are entitled to a minimum of one-half month pay for every year of service. Company A paid the equivalent of one month pay for every year of service and the cash equivalent of unused vacation and sick leaves as separation benefits.

Are such benefits taxable and subject to withholding tax under the Tax Code? Decide with reasons. (5%)

**SUGGESTED ANSWER:**

All of the benefits are not taxable, hence they are not subject to withholding tax under the Tax Code. Benefits received as a consequence of separation for any cause beyond the control of the employees such as closure of business are excluded from gross income. *(Sec. 32[B][6][b], NIRC in relation to Sec. 2[b][2], R.R. 2-98)*

### Exemptions: Stock Dividends (2003)

On 03 January 1998, X, a Filipino citizen residing in the Philippines, purchased one hundred (100) shares in the capital stock of Y Corporation, a domestic company. On 03 January 2000, Y Corporation declared, out of the profits of the company earned after 01 January 1998, a hundred percent (100%) stock dividends on all stockholders of record as of 31 December 1999 as a result of which X holding in Y Corporation became two hundred (200) shares. Are the stock dividends received by X subject to income tax? Explain. (8%)

**SUGGESTED ANSWER:**

No. Stock dividends are not realized income. Accordingly, the different provisions of the Tax Code imposing a tax on dividend income only includes within its purview cash and property dividends making stock dividends exempt from income tax. However, if the distribution of stock dividends is the equivalent of cash or property, as when the distribution results in a change of ownership interest of the shareholders, the stock dividends will be subject to income tax. *(Section 24(B)(2); Section 25(A)&(B); Section 28(B)(5)(b), 1997 Tax Code)*

### Exemptions: Strictly Construed (1996)

Why are tax exemptions strictly construed against the taxpayer?

**SUGGESTED ANSWER:**

Tax exemptions are strictly construed against the taxpayer because such provisions are highly disfavored and may almost be said to be odious to the law (***Manila Electric Company vs. Vera, 67 SCRA 351***). The exception contained in the tax statutes must be strictly construed against the one claiming the exemption because the law does not look with favor on tax exemptions they being contrary to the life-blood theory which is the underlying basis for taxes.

### Exemptions: Terminal Leave Pay (1996)

A, an employee of the Court of Appeals, retired upon reaching the compulsory age of 65 years. Upon compulsory retirement, A received the money value of his accumulated leave credits in the amount of P500.000.00. Is said amount subject to tax? Explain.

**SUGGESTED ANSWER:**

No. The commutation of leave credits, more commonly known as terminal leave pay, i.e., the cash equivalent of accumulated vacation and sick leave credits given to an officer or employee who retires, or separated from the service through no fault of his own, is exempt from income tax. (***BIR Ruling 238-91 dated November 8, 1991; Commissioner v. CA and Efren Castaneda, GR No. 96016, October 17, 1991***).

### Exemptions; Charitable Institutions (2006)

The Constitution provides "charitable institutions, churches, personages or convents appurtenant thereto, mosques, and non-profit cemeteries and all lands, buildings, and improvements actually directly and exclusively used for religious, charitable or educational purposes shall be exempt from taxation." This provision exempts charitable institutions and religious institutions from what kind of taxes? Choose the best answer. Explain. (5%)

a. from all kinds of taxes, i.e., income, VAT, customs duties, local taxes and real property tax
b. from local tax only
c. from value-added tax
d. from real property tax only
e. from capital gains tax only

**SUGGESTED ANSWER:**

The provision exemptions charitable institutions and religious institutions from (d) REAL PROPERTY TAXES only. The exemption is only for taxes assessed as property taxes, as distinguished from excise taxes ***(CIR v. CA, CTA & YMCA, G.R. No. 124043, October 14, 1998; Lladoc v. Commissioner of Internal Revenue, L-19201, June 16,1965).***

### Exemptions; Educational institution (2004)

XYZ Colleges is a non-stock, non-profit educational institution run by the Archdiocese of BP City. It collected and received the following:

(a) Tuition fees
(b) Dormitory fees
(c) Rentals from canteen concessionaires
(d) Interest from money-market placements of the tuition fees
(e) Donation of a lot and building by school alumni

Which of these above cited income and donation would not be exempt from taxation? Explain briefly. (5%)

**SUGGESTED ANSWER:**

A. All of the income derived by the non-stock, nonprofit educational institution will be exempt from taxation provided they are used actually, directly and exclusively for educational purposes. The Constitution provides that all revenues and assets of non-stock, non-profit educational institution which are actually, directly and exclusively used for educational purposes are exempt from taxation *(Section 4 par. 3, Article XIV, 1987 Constitution).*

The donation is, likewise, exempt from the donor's tax if actually, directly and exclusively used for educational purposes, provided not more than 30% of the donation is used by the donee for administration purposes. The donee, being a non-stock, non-profit educational institution, is a qualified entity to receive an exempt donation subject to conditions prescribed by law *(Section 4 par. 4, Art. XIV, 1987 Constitution, in relation to Section 101(AX3), NJRC).*

Accordingly, none of the cited income and donation collected and received by the non-stock, non-profit educational institution would not be exempt from taxation.

**ALTERNATIVE ANSWER:**

The following receipts by the non-stock, nonprofit educational institution are not exempt from taxation, viz:

(c) ***Rentals from Canteen Concessionaires***. Rental income is considered as unrelated to the school operations; hence, taxable *(DOF Order No. 137-87, Dec. 16, 1987)*

(d) ***Interest from money-market placements of the tuition fees.*** The interest on the placement is taxable *(DOF Order No. 137-87).* If however, the said interest is used actually, directly and exclusively for educational purposes as proven by substantial evidence, the same will be exempt from taxation ***(CIR v. CA, 298 SCRA 83 11998]}.***

The other items of income which were all derived from school-related activities will be exempt from taxation in the hands of the recipient if used actually, directly and exclusively for educational purposes (Section 4 par. 3, Article XTV, 1987 Constitution).

The donation to a non-stock, non-profit educational institution will be exempt from the donor's tax if used actually, directly and exclusively for educational purposes and provided, that, not more than 30% of the donation is used for administration purposes (Section 4, par. 4, Art. XJV, 1987 Constitution, in relation to Section 101(AM3), NJRC).

### Exemptions; Exemptions are Unilateral in Nature (2004)

A law was passed granting tax exemption to certain industries and investments for a period of five years. But three years later, the law was repealed. With the repeal, the exemptions were considered revoked by the BIR, which assessed the investing companies for unpaid taxes effective on the date of the repeal of the law.

NPC and KTR companies questioned the assessments on the ground that, having made their investments in full reliance with the period of exemption granted by the law, its repeal violated their constitutional right against the impairment of the obligations and contracts. Is the contention of the companies tenable or not? Reason briefly. (5%)

**SUGGESTED ANSWER:**

The contention is not tenable. The exemption granted is in the nature of a unilateral tax exemption. Since the exemption given is spontaneous on the part of the legislature and no service or duty or other remunerative conditions have been imposed on the taxpayers receiving the exemption, it may be revoked at will by the legislature (***Christ Church v. Philadelphia, 24 How. 300 [1860]***). What constitutes an impairment of the obligation of contracts is the revocation of an exemption which is founded on a valuable consideration because it takes the form and essence of a contract (***Casanovas v. Hord, 8 Phil. 125 [1907]; Manila Railroad Company v. Insular Collector of Customs, 12 Phil. 146 [1915])***

### Exemptions; Gov't Bonus, Gifts, & Allowances (1994)

In December 1993, the Sangguniang Bayan authorized a Christmas bonus of P3,000.00, a cash gift of P5,000.00 and transportation and representation allowance of P6,000.00 for each of the municipal employees.

1) Is the Christmas bonus subject to any tax?
2) How about the cash gift?
3) How about the transportation and representation allowances?

**SUGGESTED ANSWER:**

1) The CHRISTMAS BONUS given by the Sangguniang Bayan to the municipal employees is taxable as additional compensation (Sec. 21 (a). Tax Code).

2) The cash gift per employee of P5.000.00 being substantial may be considered taxable also. They partake the nature of additional compensation income as it is highly doubtful if municipal governments are authorized to make gifts in substantial sums such as this. They are not furthermore gifts of "small value" which employers might give to their employees on special occasions like Christmas - items which could be exempt under BIR Revenue Audit Memo No. 1-87.

3) The transportation and representation allowances are actually reimbursements for expenses incurred by the employee for the employer. Said allowances spent by the employee for the employer are designed to enhance the quality of the service that the employer is supposed to perform for its clientele like the people of the municipality.

### Exemptions; Personal & Additional Exemption (2006)

Charlie, a widower, has two sons by his previous marriage. Charlie lives with Jane who is legally married to Mario. They have a child named Jill. The children are all minors and not gainfully employed.

***1. How much personal exemption can Charlie claim? Explain. (2.5%)***

**SUGGESTED ANSWER:**

Charlie can claim the personal exemption of a Head of a Family or P25,000.00 provided that, at least one of his minor and not gainfully employed children is unmarried and living with and dependent upon him for chief support *(Tax Reform Act, RA 8424, Chapter VII, Section 35[A]; BIR Revenue Regulation 02-98).*

***2. How much additional exemption can Charlie claim? Explain. (2.5%)***

**SUGGESTED ANSWER:**

His children from his previous marriage who are legitimate children and his illegitimate child with Jane will all entitle him to additional personal exemption of P8,000.00 for each dependent, if apart from being minor and not gainfully employed, they are unmarried, living with and dependent upon Charlie for their chief support *(Tax Reform Act, RA8424, Chapter VH, Section 35(A); BIR Revenue Regulation 02-98).*

### Exemptions; Roman Catholic Church; Limitations (2005)

The Roman Catholic Church owns a 2-hectare lot, in a town in Tarlac province. The southern side and middle part are occupied by the Church and a convent, the eastern side by a school run by the Church itself, the southeastern side by some commercial establishments, while the rest of the property, in particular the northwestern side, is idle or unoccupied.

May the Church claim tax exemption on the entire land? Decide with reasons.

**SUGGESTED ANSWER:**

No. The Church cannot claim tax exemption on the entire land. Only the southern side and middle part that are occupied by the Church and a convent and the eastern side occupied by a school run by the Church itself are exempt, because such parts of the 2-hectare lot are actually, directly and exclusively used for religious and educational purposes. *(Sec. 28[3], Art. VI, 1987 Constitution; Sec. 234, Local Government Code)*

The southeastern side occupied by some commercial establishment is not tax exempt. If real property is used for one or more commercial purposes, it is not exclusively used for the exempted purpose but is subject to taxation. 'Solely' is synonymous with 'exclusively.' ***(Lung Center of the Philippines v. Quezon City, G.R. No. 144104, June 29, 2004)*** The property must be exclusively (solely) used for religious or educational purposes.

Of course, it is apparent that the northwestern side, which is idle or unoccupied is not "actually, directly and exclusively" used for religious or educational purposes, hence not exempt from taxation.

## CAPITAL GAIN TAX

### Capital Asset vs. Ordinary Asset (2003)

Distinguish a "capital asset" from an "ordinary asset".

**SUGGESTED ANSWER:**

(a) The term "capital asset" regards all properties not specifically excluded in the statutory definition of capital assets, the profits or loss on the sale or the exchange of which are treated as capital gains or capital losses. Conversely, all those properties specifically excluded are considered as ordinary assets and the profits or losses realized must have to be treated as ordinary gains or ordinary losses. Accordingly, "***Capital Assets***" includes property held by the taxpayer whether or not connected with his trade or business, but the term does not include any of the following, which are consequently considered "ordinary assets":

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year;

(2) property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;

(3) property used in the trade or business of a character which is subject to the allowance for depreciation provided in Section 34 (F) of the Tax Code; or

(4) real property used in trade or business of the taxpayer.

The statutory definition of "capital assets" practically excludes from its scope, it will be noted, all property held by the taxpayer if used in connection with his trade or business.

### Capital Gain Tax; Nature (2001)

A, a doctor by profession, sold in the year 2000 a parcel of land which he bought as a form of investment in 1990 for Php 1 million. The land was sold to B, his colleague, at a time when the real estate prices had gone down and so the land was sold only for Php 800,000 which was then the fair market value of the land. He used the proceeds to finance his trip to the United States. He claims that he should not be made to pay the 6% final tax because he did not have any actual gain on the sale. Is his contention correct? Why? (5%)

**SUGGESTED ANSWER:**

No. The 6% capital gains tax on sale of a real property held as capital asset is imposed on the income presumed to have been realized from the sale which is the fair market value or selling price thereof, whichever is higher. (Section 24(D), NIRC). Actual gain is not required for the imposition of the tax but it is the gain by fiction of law which is taxable.

### Ordinary Sale of a Capital Asset (1994)

Noel Langit and his brother, Jovy, bought a parcel of land which they registered in their names as pro-indiviso owners (Parcel A). Subsequently, they formed a partnership, duly registered with Securities and Exchange Commission, which bought another parcel of land (Parcel B). Both parcels of land were sold, realizing a net profit of P1,000,000.00 for parcel A and P500.000.00 for parcel B.

The BIR claims that the sale of parcel A should be taxed as a sale by an unregistered partnership. Is the BIR correct?

**SUGGESTED ANSWER:**

The BIR is not correct, since there is no showing that the acquisition of the property by Noel and Jovy Langit as pro indiviso owners, and prior to the formation of the partnership, was used, intended for use, or bears any relation whatsoever to the pursuit or conduct of the partnership business. The sale of parcel A shall therefore not be treated as a sale by an unregistered partnership, but an ordinary sale of a capital asset, and hence will be subject to the 5% capital gains tax and documentary

stamp tax on transfers of real property, said taxes to be borne equally by the co-owners.

**ALTERNATIVE ANSWER:**

The BIR is correct in treating the gain from the sale of parcel of land by Noel and Jovy Langit at a profit of P1,000,000.00. In the case of ***Pascual and Dragon v. Commissioner, G.R. No. 78133, October 18, 1988***, the Supreme Court ruled that the sharing of returns does not in itself establish a partnership, whether or not the persons sharing therein have a joint or common right or interest in the property. The decision in said case cannot be applied here because clearly the parties organized a partnership duly registered with the Securities and Exchange Commission. They pooled their resources together with the purpose of dividing the profit between them.

### Sales of Share of Stocks: Capital Gains Tax Return (1999)

HK Co. is a Hong Kong corporation not doing business in the Philippines. It holds 40% of the shares of A Co., a Philippine company, while the 60% is owned by P Co., a Filipino-owned Philippine corporation. HK Co. also owns 100% of the shares of B Co., an Indonesian company which has a duly licensed Philippine branch. Due to worldwide restructuring of the HK Co. group, HK Co. decided to sell all its shares in A and B Cos. The negotiations for the buy-out and the signing of the Agreement of Sale were all done in the Philippines. The Agreement provides that the purchase price will be paid to HK Co's bank account in the U. S. and that little to A and B Cos. Shares will pass from HK Co. to P Co. in HK where the stock certificates will be delivered. P Co. seeks your advice as to whether or not it will subject the payments of purchase price to Withholding Tax. Explain your advice. (10%)

**SUGGESTED ANSWER:**

P Co. should not subject the payments of the purchase price to withholding tax. While the seller is a non-resident foreign corporation which is not normally required to file returns in the Philippines, therefore, ordinarily all its income earned from Philippine sources is taxed via the withholding tax system, this is not the procedure availing with respect to sales of shares of stock. The capital gains tax on the sale of shares of stock of a domestic corporation is always required to be paid through a capital gains tax return filed. The sale of the shares of stock of the Indonesian Corporation is not subject to income tax under our jurisdiction because the income derived there from is considered as a foreign-sourced income.

**ALTERNATIVE ANSWER:**

Yes, but only on the shares of stocks of A Co. and only on the portion of the purchase price, which constitutes capital gains. Under the Tax Code of 1997, the capital gains tax imposed under Section 28(B)(5)(c) is collectible via the withholding of tax at source pursuant to Section 57 of the same Code.

(Note: The bar candidate might have relied on the provision of the Tax Code of 1997 which provides that the capital gains tax is imposed as withholding taxes (Section 57, NIRC). This procedure is impractical and, therefore, not followed in practice because the buyer/ withholding agent will not be in a position to determine how much income is realized by the seller from the sale. For this reason, any of the foregoing suggested answers should be given full credit).

### Tax Basis: Capital Gains: Merger of Corporations (1994)

In a qualified merger under Section 34 (c) (2) of the Tax Code, what is the tax basis for computing the capital gains on: (a) the sale of the assets received by the surviving corporation from the absorbed corporation; and (b) the sale of the shares of stock received by the stockholders from the surviving corporation?

**SUGGESTED ANSWER:**

In a qualified merger under Section 34 (c) (2) of the Tax Code, the tax basis for computing the capital gains on:

(a) the sale of the assets received by the surviving corporation from the absorbed corporation shall be the original/historical cost of the assets when still in the hands of the absorbed corporation.

(b) the sale of the shares of stock received by the stockholders from the surviving corporation shall be the acquisition/historical cost of assets transferred to the surviving corporation.

### Tax Basis: Capital Gains: Tax-Free Exchange of Property (1994)

In a qualified tax-free exchange of property for shares under Section 34 (c) (2) of the Tax Code, what is the tax basis for computing the capital gains on: (a) the sale of the assets received by the Corporation; and (b) the sale of the shares received by the stockholders in exchange of the assets?

**SUGGESTED ANSWER:**

In a qualified tax free exchange of property for shares under Section 34 (c) (2) of the Tax Code, the tax basis for computing the gain on the:

(a) sale of the assets received by the corporation shall be the original/historical cost (purchase price plus expenses of acquisition) of the property/ assets given in exchange of the shares of stock.

(b) sale of the shares of stock received by the stockholders in exchange of the assets shall be the original/historical cost of the property given in exchange of the shares of stock.

**ALTERNATIVE ANSWER:**

The basis in computing capital gains tax in a qualified tax-free exchange under Sec. 34 (c) (2) is:

(a) With respect to the asset received by the corporation the same as it would be in the hands of the transferor increased by the amount of the gain recognized to the transferor on the transfer.

(b) With respect to the shares received by the stockholders in exchange of the assets - the same as the basis of the property, stock or securities exchanged, decreased by the money received and the fair market value of the other property received, and increased by the amount treated as dividend of the shareholder and the amount of any gain that was recognized on the exchange.

## CORPORATION & PARTNERSHIP

### Bad Debts; Factors; Elements thereof (2004)

PQR Corp. claimed as a deduction in its tax returns the amount of P1,000,000 as bad debts. The corporation was assessed by the Commissioner of Internal Revenue for deficiency taxes on the ground that the debts cannot be considered as "worthless," hence they do not qualify as bad debts. The company asks for your advice on "What factors will held in determining whether or not the debts are bad debts?" Answer and explain briefly. (5%)

**SUGGESTED ANSWER:**

In order that debts be considered as bad debts because they have become worthless, the taxpayer should establish that during the year for which the deduction is sought, a situation developed as a result of which it became evident in the exercise of sound, objective business judgment that there remained no practical, but only vaguely theoretical, prospect that the debt would ever be paid ***(Collector of Internal Revenue v. Goodrich International Rubber Co., 21 SCRA 1336 [1967]).*** "Worthless" is not determined by an inflexible formula or slide rule calculation, but upon the exercise of sound business judgment. The factors to be considered include, but are not limited to, the following:

1. The debtor has no property nor visible income;
2. The debtor has been adjudged bankrupt or insolvent;
3. Collateral shares have become worthless; and
4. There are numerous debtors with small amounts of debts and further action on the accounts would entail expenses exceeding the amounts sought to be collected.

**ALTERNATIVE ANSWER:**

The following are the factors to be considered in determining whether or not the debts are bad debts:

1. The debt must be valid and subsisting;
2. The debt is connected with the taxpayer's trade or business, and is not between related parties;
3. There is an actual ascertainment that the debt is worthless; and
4. The debt is charged-off within the taxable year. ***(PRC v. CA, 256 SCRA 667 [1996]; Revenue Regs. No. 5-99).***

### Condominium Corp.; Sale of Common Areas (1994)

X-land Condominium Corporation was organized by the owners of units in X-land Building in accordance with the Master Deed with Declaration of Restrictions. The X-land Building Corporation, the developer of the building, conveyed the common areas in favor of the X-land Condominium Corporation. Is the conveyance subject to any tax?

**SUGGESTED ANSWER:**

The conveyance is not subject to any tax. The same is without consideration, and not in connection with a sale made to X-land Condominium Corporation, and the purpose of the conveyance to the latter is for the management of the common areas for the common benefit of the unit owners.

The same is not subject to income tax since no income was realized as a result of the conveyance, which was made pursuant to the Condominium Act (R.A. No. 4626, and the purpose of which was merely to vest title to the common areas in favor of the Land Condominium Corporation.

There being no monetary consideration, neither is the conveyance subject to the creditable withholding tax imposed under Revenue Regulations 1-90, as amended.

The second conveyance was actually no conveyance at all because when the units were sold to the various buyers, the common areas were already part and parcel of the sale of said units pursuant to the Condominium Act. However, the Deed of Conveyance is subject to documentary stamp tax.

*N.B. Documentary stamps tax and Condominium Law are excluded from the coverage of the Bar Examinations.*

### Corporation; Sale; Creditable Withholding Tax (1994)

Noel Langit and his brother, Jovy, bought a parcel of land which they registered in their names as pro-indiviso owners (Parcel A). Subsequently, they formed a partnership, duly registered with Securities and Exchange Commission, which bought another parcel of land (Parcel B). Both parcels of land were sold, realizing a net profit of P1,000,000.00 for parcel A and P500.000.00 for parcel B.

The BIR also claims that the sale of parcel B should be taxed as a sale by a corporation. Is the BIR correct?

**SUGGESTED ANSWER:**

The BIR is correct, since a "corporation" as defined under Section 20 (a) of the Tax Code includes partnerships, no matter how created or organized, except general professional partnerships. The business partnership, in the instant case, shall therefore be taxed in the same manner as a corporation on the sale of parcel B. The sale shall thus be subject to the creditable withholding tax under Revenue Regulations 1-90, as amended by 12-94, on the sale of parcel B, and the partnership shall report the gain realized from the sale when it files its income tax return.

### Dividends: Withholding Tax (1999)

HK Co., is a Hong Kong company, which has a duly licensed Philippine branch, engaged in trading activities in the Philippines. HK Co. also invested directly in 40% of the shares of stock of A Co., a Philippine corporation. These shares are booked in the Head Office of HK Co. and are not reflected as assets of the Philippine branch. In 1998, A Co. declared dividends to its stockholders. Before remitting the dividends to HK Co., A Co. seeks your advice as to whether it will subject the remittance to WT. No need to discuss WT rates, if applicable. Focus your discussion on what is the issue. (10%)

**SUGGESTED ANSWER:**

I will advise A Co. to withhold and remit the withholding tax on the dividends. While the general rule is that a foreign corporation is the same juridical entity as its branch office in the Philippines, when, however, the corporation transacts business in the Philippines directly and independently of its branch, the taxpayer would be the foreign corporation itself and subject to the dividend tax similarly imposed on non-resident foreign corporation. The dividends attributable to the Home Office would not qualify as dividends earned by a resident foreign corporation, which is exempt from tax. ***(Marubeni Corporation v. Commissioner, GR No. 76573, September 14, 1989).***

### Effect: Dissolution; Corporate Existence (2004)

For failure to comply with certain corporate requirements, the stockholders of ABC Corp. were notified by the Securities and Exchange Commission that the corporation would be subject to involuntary dissolution. The stockholders did not do anything to comply with the requirements, and the corporation was dissolved. Can the stockholders be held personally liable for the unpaid taxes of the dissolved corporation? Explain briefly. (5%)

**SUGGESTED ANSWER:**

No. As a general rule, stockholders cannot be held personally liable for the unpaid taxes of a dissolved corporation. The rule prevailing under our jurisdiction is that a corporation is vested by law with a personality that is separate and distinct from those of the persons composing it ***(Sunio v. NLRC, 127 SCRA 390{1984]}.***

> NOTE: additional point should be given to the examinee if he answers in the following that: However, stockholders may be held liable for the unpaid taxes of a dissolved corporation if it appears that the corporate assets have passed into their hands ***(Tan Tiong Bio v. CFR, 4 SCRA 986 [1962]).*** Likewise, when stockholders have unpaid subscriptions to the capital of the corporation they can be made liable for unpaid taxes of the corporation to the extent of their unpaid subscriptions.

### Minimum Corporate Income Tax (2001)

What is the rationale of the law in imposing what is known as the Minimum Corporate Income tax on Domestic Corporations? (3%)

**SUGGESTED ANSWER:**

The imposition of the Minimum Corporate Income Tax (MCIT) is designed to forestall the prevailing practice of corporations of over claiming deductions in order to reduce their income tax payments. The filing of income tax returns showing a tax loss every year goes against the business motive which impelled the stockholders to form the corporation. This is the reason why domestic corporations (and resident foreign corporations) after the recovery period of four years from the time they commence business operations, they become liable to the MCIT whenever this tax imposed at 2% of gross income exceeds the normal corporate income tax imposed on net income. (Sponsorship Speech, Chairman of Senate Ways and Means Committee).

### Minimum Corporate Income Tax; Exemption (2001)

Is a corporation which is exempted from the minimum corporate income tax automatically exempted from the regular corporate income tax? Explain your answer. (2%)

**SUGGESTED ANSWER:**

No. The minimum corporate income tax is a proxy for the normal corporate income tax, not the regular corporate income tax paid by a corporation. For instance, a proprietary educational institution may be subject to a regular corporate income tax of 10% (depending on its dominant income), but it is exempt from the imposition of MCIT because the latter is not intended to substitute special tax rates. So is with PEZA enterprises, CDA enterprises etc.

> [Note: If what is meant by regular income tax is the 32% tax rate imposed on taxable income of corporations, the answer would be in the affirmative, because domestic corporations and resident foreign corporations are either liable for the 2% of gross income (MCIT) or 32% of net income (the normal corporate income tax) whichever is higher.]

**ALTERNATIVE ANSWER:**

No. A corporation which is exempted from the minimum corporate income tax is not automatically exempted from the regular corporate income tax. The reason for this is that MCIT is imposed only beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations. Thus, a corporation may be exempt from MCIT because it is only on its third year of operations following its commencement of business operations.

## ESTATE & DONOR'S TAXES

### Donor's Tax: Election Contributions (1998)

Are contributions to a candidate in an election subject to donor's tax? On the part of the contributor, is it allowable as a deduction from gross income? [5%]

**SUGGESTED ANSWER:**

1) No, provided the recipient candidate had complied with the requirement for filing of returns of contributions with the Commission on Elections as required under the Omnibus Election Code.

2) The contributor is not allowed to deduct the contributions because the said expense is not directly attributable to, the development, management, operation and/or conduct of a trade, business or profession {*Sec. 34[AJ(l)(a), NIRC).* Furthermore, if the candidate is an incumbent government official or employee, it may even be considered as a bribe or a kickback (Sec. 34[AJ(l)(c), NIRC).

> **COMMENT:** It is suggested that full credit should be given for any answer to the first question because the answer requires an interpretation of the Election Code. Pursuant to the provisions of Section 99(C) of the NIRC, the taxability of this type of contributions/donations is governed by the Election Code.

### Donor's Tax; Basis for Determining Gain (1995)

(1) Kenneth Yusoph owns a commercial lot which he bought many years ago for P1 Million. It is now worth P20 Million although the zonal value is only P15 Million. He donates one-half pro-indiviso interest in the land to his son Dino on 31 December 1994, and the other one-half pro-indiviso interest to the same son on 2 January 1995.

How much is the value of the gifts in 1994 and 1995 for purposes of computing the gift tax? Explain.

**SUGGESTED ANSWER:**

1) The value of the gifts for purposes of computing the gift tax shall be P7.5million in 1994 and P7.5million in

1995. In valuing a real property for gift tax purposes the property should be appraised at the higher of two values as of the time of donation which are (a) the fair market value as determined by the Commissioner (which is the zonal value fixed pursuant to Section 16(e) of the Tax Code), or (b) the fair market value as shown in the schedule of values fixed by the Provincial and City Assessors. The fact that the property is worth P20 million as of the time of donation is immaterial unless it can be shown that this value is one of the two values mentioned as provided under Section 81 of the Tax Code.

(2) The Revenue District Officer questions the splitting of the donations into 1994 and 1995. He says that since there were only two (2) days separating the two donations they should be treated as one, having been made within one year. Is he correct? Explain.

**SUGGESTED ANSWER:**

2) The Revenue District Officer is not correct because the computation of the gift tax is cumulative but only insofar as gifts made within the same calendar year. Therefore, there is no legal justification for treating two gifts effected in two separate calendar years as one gift.

(3) Dino subsequently sold the land to a buyer for P 20 Million. How much did Dino gain on the sale? Explain.

**SUGGESTED ANSWER:**

3) Dino gained an income of 19 million from the sale. Dino acquires a carry-over basis which is the basis of the property in the hands of the donor or P1 million. The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis or adjusted basis for determining gain (Sec. 34(a), NIRC). Since the property was acquired by gift, the basis for determining gain shall be the same as if it would be in the hands of the donor or the last preceding owner by whom the property was not acquired by gift. Hence, the gain is computed by deducting the basis of P1 million from the amount realized which is P20 million.

(4) Suppose, instead of receiving the lot by way of donation, Dino received it by inheritance. What would be his gain on the sale of the lot for P20 Million? Explain.

**SUGGESTED ANSWER:**

4) If the commercial lot was received by inheritance the gain from the sale for P20 million is P5 million because the basis is the fair market value as of the date of acquisition. The stepped-up basis of P15 million which is the value for estate tax purposes is the basis for determining the gain (Sec. 34(b)(2), NIRC).

**ALTERNATIVE ANSWER:**

If Dino held on to the property as a capital asset in that it is neither for sale in the ordinary course of business nor used in Dino's business, then upon sale thereof there is presumed to be realized an income of P20 million which is the gross selling price of the property. (Sec. 21(e), NIRC). The same would be subject to the 5% capital gains tax.

### Donor's Tax; Dacion en Pago; Effect: Taxation (1997)

An insolvent company had an outstanding obligation of P l00,000.00 from a creditor. Since it could not pay the debt, the creditor agreed to accept payment through dacion en pago a property which had a market value of P30.000.00. In the dacion en pago document, the balance of the debt was condoned.

A. What is the tax effect on the discharge of the unpaid balance of the obligation on the debtor corporation?
B. Insofar as the creditor is concerned, how is he effected tax-wise as a consequence of the transaction?

**SUGGESTED ANSWERS:**

(a) The condonation of the unpaid balance of the obligation has the effect of a donation made on the part of the creditor. It is obvious that the creditor merely desires to benefit the debtor and without any consideration therefore cancels the debt, the amount of the debt cancelled is a gift from the creditor to the debtor and need not be included in the latter's gross income (Sec. 50, RR No. 2);

(b) For the difference of P70,000 the creditor shall be subject to donor's tax at the applicable rates provided for under the National Internal Revenue Code.

**ALTERNATIVE ANSWER:**

(a) If the discharge was prompted by the insolvency of the debtor company, then it is a clear case of a write-off of a bad debts which has no tax consequence to the debtor.

(b) The write-off of the bad debt will entitle the creditor to claim the same as a deduction from its gross income.

### Donor's Tax; Donation to a Sibling (2001)

Your bachelor client, a Filipino residing in Quezon City, wants to give his sister a gift of Php 200,000.00. He seeks your advice, for purposes of reducing if not eliminating the donor's tax on the gift, on whether it is better for him to give all of the Php 200,000.00 on Christmas 2001 or to give Php 100,000.00 on Christmas2001 and the other Php 100,000.00 on January 1, 2002. Please explain your advice. (5%)

**SUGGESTED ANSWER:**

I would advice him to split the donation. Giving the Php200,000 as a one-time donation would mean that it will be subject to a higher tax bracket under the graduated tax structure thereby necessitating the payment of donor's tax. On the other hand, splitting the donation into two equal amounts of Php 100,000 given on two different years will totally relieve the donor from the donor's tax because the first Phpl00.000 donation in the graduated brackets is exempt. (Section 99, NIRC). While the donor's tax is computed on the cumulative donations, the aggregation of all donations made by a donor is allowed only over one calendar year.

### Donor's Tax; Donation to Non-Stock, Non-Profit Private Educational Institutions (2000)

What conditions must occur in order that all grants, donations and contributions to non-stock, non-profit private educational institutions may be exempt from the donor's tax under Section 101 (a) of the Tax Code? (3%)

**SUGGESTED ANSWER:**

The following are the conditions:

1. Not more than thirty percent (30%) of said gifts shall be used by such donee for administration purposes;
2. The educational institution is incorporated as a non-stock entity,
3. paying no dividends,
4. governed by trustees who receive no compensation, and
5. devoting all its income, whether students' fees or gifts, donations, subsidies or other forms of philanthropy, to the accomplishment and promotion of the purposes enumerated in its Articles of Incorporation. (Sec. 101 (A) (3), NIRC of 1997]

### Donor's Tax; Donation to Political Candidate (2003)

X is a friend of Y, the chairman of Political Party Z, who wants to run for President in the 2004 elections. Knowing that Y needs funds for posters and streamers, X is thinking of donating to Y P150,000.00 for his campaign. He asks you whether his intended donation to Y will be subject to the donor's tax. What would your answer be? Will your answer be the same if he were to donate to Political Party Z instead of to Y directly? (8%)

**SUGGESTED ANSWER:**

The donation to Y, once he becomes a candidate for an elective post, is not subject to donor's tax provided that he complies with the requirement of filing returns of contributions with the Commission on Elections as required under the Omnibus Election Code.

The answer would be the same if X had donated the amount to Political Party Z instead of to Y directly because the law places in equal footing any contribution to any candidate, political party or coalition of parties for campaign purposes. *(Section 99(C) of the 1997 Tax Code).*

### Donor's Tax; Donee or Beneficiary; Stranger (2000)

When the donee or beneficiary is a stranger, the tax payable by the donor shall be 30% of the net gifts. For purposes of this tax, who is a stranger? (2%)

**SUGGESTED ANSWER:**

A STRANGER is a person who is not a:

A. Brother, sister (whether by whole or half-blood), spouse, ancestor and lineal descendant; or
B. Relative by consanguinity in the collateral line within the fourth degree of relationship." [Sec. 98 (B), NIRC of 1997]

### Donor's Tax; Sale of shares of Stock & Sale of Real Property (1999)

A, an individual, sold to B, his brother-in-law, his lot with a market value of P1,000,000 for P600.000. A's cost in the lot is P100.000. B is financially capable of buying the lot.

A also owns X Co., which has a fast growing business. A sold some of his shares of stock in X Co. to his key executives in X Co. These executives are not related to A. The selling price is P3,000,000, which is the book value of the shares sold but with a market value of P5,000,000. A's cost in the shares sold is P1,000,000. The purpose of A in selling the shares is to enable his key executives to acquire a propriety interest in the business and have a personal stake in its business. Explain if the above transactions are subject to donor's tax. (5%)

**SUGGESTED ANSWER:**

The first transaction where a lot was sold by A to his brother-in-law for a price below its fair market value will not be subject to donor's tax if the lot qualifies as a capital asset. *The transfer for less than adequate and full consideration, which gives rise to a deemed gift, does not apply to a sale of property subject to capital gains tax.* (Section 100, NIRC). However, if the lot sold is an ordinary asset, the excess of the fair market value over the consideration received shall be considered as a gift subject to the donor's tax.

The sale of shares of stock below the fair market value thereof is subject to the donor's tax pursuant to the provisions of Section 100 of the Tax Code. The excess of the fair market value over the selling price is a deemed gift.

**ALTERNATIVE ANSWER:**

The sale of shares of stock below the fair market value will not give rise to the imposition of the donor's tax. In determining the gain from the transfer, the selling price of the shares of stocks shall be the fair market value of the shares of stocks transferred. (Section 6, RR No. 2-82). In which case, the reason for the imposition of the donor's tax on sales for inadequate consideration does not exist.

### Estate Tax: Comprehensive Agrarian Reform Law (1994)

Jose Ortiz owns 100 hectares of agricultural land planted to coconut trees. He died on May 30, 1994. Prior to his death, the government, by operation of law, acquired under the Comprehensive Agrarian Reform Law all his agricultural lands except five (5) hectares. Upon the death of Ortiz, his widow asked you how she will consider the 100 hectares of agricultural land in the preparation of the estate tax return. What advice will you give her?

**SUGGESTED ANSWER:**

The 100 hectares of land that Jose Ortiz owned but which prior to his death on May 30, 1994 were acquired by the government under CARP are no longer part of his taxable gross estate, with the exception of the remaining five (5) hectares which under Sec. 78{a) of the Tax Code still forms part of "decedent's interest".

### Estate Tax: Donation Mortis Causa (2001)

A, aged 90 years and suffering from incurable cancer, on August 1, 2001 wrote a will and, on the same day, made several inter-vivos gifts to his children. Ten days later, he died. In your opinion, are the inter-vivos gifts considered transfers in contemplation of death for purposes of determining properties to be included in his gross estate? Explain your answer. (5%)

**SUGGESTED ANSWER:**

Yes. When the donor makes his will within a short time of, or simultaneously with, the making of gifts, the gifts are considered as having been made in contemplation of death. (***Roces v. Posadas, 58 Phil. 108***). Obviously, the intention of the donor in making the inter-vivos gifts is to avoid the imposition of the estate tax and since the donees are likewise his forced heirs who are called upon to inherit, it will create a presumption *juris tantum* that said donations were made *mortis causa*, hence, the properties donated shall be included as part of A's gross estate.

### Estate Tax: Donation Mortis Causa vs. Inter Vivos (1994)

Are donations inter vivos and donations mortis causa subject to estate taxes?

**SUGGESTED ANSWER:**

Donations inter vivos are subject to donor's gift tax (Sec. 91 (a). Tax Code) while donations mortis causa are subject to estate tax (Sec. 77, Tax Code). However, donations inter vivos, actually constituting taxable lifetime like transfers in contemplation of death or revocable transfers (Sec. 78 (b) and (c), Tax Code) may be taxed for estate tax purposes, the theory being that the transferor's control thereon extends up to the time of his death.

**ALTERNATIVE ANSWER:**

Donations inter vivos are not subject to estate taxes because the transfer of the property take effect during the lifetime of the donor. The transfer is therefore subject to the donor's tax.

On the other hand, donations mortis causa are subject to estate taxes since the transfer of the properties takes effect after the death of the decedent. Such donated properties, real or personal, tangible or intangible, shall form part of the gross estate.

### Estate Tax: Gross Estate: Allowable Deduction (2001)

On the first anniversary of the death of Y, his heirs hosted a sumptuous dinner for his doctors, nurses, and others who attended to Y during his last illness. The cost of the dinner amounted to Php 50,000.00. Compared to his gross estate, the Php 50,000.00 did not exceed five percent of the estate. Is the said cost of the dinner to commemorate his one year death anniversary deductible from his gross estate? Explain your answer. (5%)

**SUGGESTED ANSWER:**

No. This expense will not fall under any of the allowable deductions from gross estate. Whether viewed in the context of either funeral expenses or medical expenses, the same will not qualify as a deduction. Funeral expenses may include medical expenses of the last illness but not expenses incurred after burial nor expenses incurred to commemorate the death anniversary. ***(De Guzman V. De Guzman, 83 SCRA 256).*** Medical expenses, on the other hand, are allowed only if incurred by the decedent within one year prior to his death. (Section 86(A)(6), NIRC).

### Estate Tax: Gross Estate: Deductions (2000)

Mr. Felix de la Cruz, a bachelor resident citizen, suffered from a heart attack while on a business trip to the USA. He died intestate on June 15, 2000 in New York City, leaving behind real properties situated in New York; his family home in Valle Verde, Pasig City; an office condominium in Makati City; shares of stocks in San Miguel Corporation; cash in bank; and personal belongings. The decedent is heavily insured with Insular Life. He had no known debts at the time of his death. As the sole heir and appointed Administrator, how would you determine the gross estate of the decedent? What deductions may be claimed by the estate and when and where shall the return be filed and estate tax paid? (3%)

**SUGGESTED ANSWER:**

The gross estate shall be determined by including the value at the time of his death ***all of the properties mentioned***, to the extent of the interest he had at the time of his death *because he is a Filipino citizen*. [Sec. 85 (A), NIRC of 1997]

With respect to the ***life insurance proceeds***, the amount includible in the gross estate for Philippine tax purposes would be to the extent of the amount receivable by the estate of the deceased, his executor, or administrator, under policies taken out by decedent upon his own life, irrespective of whether or not the insured retained the power of revocation, or to the extent of the amount receivable by any beneficiary designated in the policy of insurance, except when it is expressly stipulated that the designation of the beneficiary is irrevocable. [Sec. 85 (E) NIRC of 1997]

The ***DEDUCTIONS*** that may be claimed by the estate are:

1) The actual funeral expenses or in an amount equal to five percent (5%) of the gross estate, whichever is lower, but in no case to exceed two hundred thousand pesos (P200.000.00). [Sec. 86 (A) (1) (a). NIRC of 1997]

2) The judicial expenses in the testate or intestate proceedings.(Sec. 86(A)(1)

3) The value of the decedent's family home located in Valle Verde, Pasig City in an amount not exceeding one million pesos (P1,000,000.00), and upon presentation of a certification of the barangay captain of the locality that the same have been the decedent's family home. [Sec. 86 (A) (4), Ibid]

4) The standard deduction of P1,000,000. (Sec. 86(A)(5)

5) Medical expenses incurred within one year from death in an amount not exceeding P500,000.(Sec. 86(A)(6)

The ***ESTATE TAX RETURN*** shall be filed within six (6) months from the decedent's death (Sec. 90 (B), NIRC of 1997], provided that the Commissioner of Internal Revenue shall have authority to grant in meritorious cases, a reasonable extension not exceeding thirty (30) days for filing the return (Sec. 90 (c), Ibid]

Except in cases where the Commissioner of Internal Revenue otherwise permits, the estate tax return shall be filed with an authorized agent bank, or Revenue District Officer, Collection Officer, or duly authorized Treasurer of Pasig City, the City in which the decedent Mr. de la Cruz was domiciled at the time of his death. [Sec. 90 (D). NIRC of 1997]

### Estate Tax: Inclusion: Resident Alien (1994)

Cliff Robertson, an American citizen, was a permanent resident of the Philippines. He died in Miami, Florida. He left 10,000 shares of Meralco, a condominium unit at the

Twin Towers Building at Pasig, Metro Manila and a house and lot in Los Angeles, California.

What assets shall be included in the Estate Tax Return to be filed with the BIR?

**SUGGESTED ANSWER:**

All of Mr. Robertson's assets consisting of 10,000 shares in the Meralco, a condominium unit in Pasig, and his house and lot in Los Angeles, California are taxable. The properties of a resident alien decedent like Mr. Robertson are taxable wherever situated (Sees. 77, 78 and 98, Tax Code).

### Estate Tax: Payment vs. Probate Proceedings (2004)

VCC is the administrator of the estate of his father NGC, in the estate proceedings pending before the MM Regional Trial Court. Last year, he received from the Commissioner of Internal Revenue a deficiency tax assessment for the estate in the amount of P1,000,000. But he ignored the notice. Last month, the BIR effected a levy on the real properties of the estate to pay the delinquent tax. VCC filed a motion with the probate court to stop the enforcement and collection of the tax on the ground that the BIR should have secured first the approval of the probate court, which had jurisdiction over the estate, before levying on its real properties. Is VCC's contention correct? (5%)

**SUGGGESTED ANSWER:**

No. VCC's contention is not correct. The approval of the probate court is not necessary. Payment of estate taxes is a condition precedent for the distribution of the properties of the decedent and the collection of estate taxes is executive in nature for which the court is devoid of any jurisdiction. Hence, the approval of the court, sitting in probate, or as a settlement tribunal is not a mandatory requirement in the collection of estate taxes (***Marcos H v. Court of Appeals, 273 SCRA 47 [1997***]).

### Estate Tax: Situs of Taxation: Non-Resident Decedent (2000)

Discuss the rule on *situs of taxation* with respect to the imposition of the estate tax on property left behind by a non-resident decedent. (2%)

**SUGGESTED ANSWER:**

The value of the gross estate of a non-resident decedent who is a Filipino citizen at the time of his death shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated to the extent of the interest therein of the decedent at the time of his death [Sec. 85 (A), NIRC of 1997). These properties shall have a situs of taxation in the Philippines hence subject to Philippine estate taxes.

On the other hand, in the case of a non-resident decedent who at the time of his death was not a citizen of the Philippines, *only that part of the entire gross estate which is situated in the Philippines to the extent of the interest therein of the decedent at the time of his death shall be included in his taxable estate.* Provided, that, with respect to intangible personal property, we apply the rule of reciprocity. (Ibid)

### Estate Tax: Vanishing Deductions (1994)

Vanishing deductions in estate-taxation?

**SUGGESTED ANSWER:**

Vanishing deductions or property previously taxed in estate taxation refers to the diminishing deducibility/ exemption, at the rate of 20% over a period of five (5) years until it is lost after the fifth year, of any property (situated in the Philippines) forming part of the gross estate, acquired by the decedent from a prior decedent who died within a period of five (5) years from the decedent's death.

### Estate Tax; Payment vs. Probate Proceedings (2005)

Is the approval of the court, sitting as probate or estate settlement court, required in the enforcement and collection of estate tax? Explain.

**SUGGESTED ANSWER:**

No, the approval of the court, sitting in probate, or as a settlement tribunal over the deceased is not a mandatory requirement in the collection of estate taxes. There is nothing in the Tax Code, and in the pertinent remedial laws that implies the necessity of the probate or estate settlement court's approval of the state's claim for estate taxes, before the same can be enforced and collected. ***(Marcos v. Court of Appeals, G.R. No. 120880, June 5, 1997)***

## BUSINESS TAXES

### VAT: Basis of VAT (1996)

***What is the basis of the Value-Added Tax on taxable sales of real property?***

**SUGGESTED ANSWER:**

The basis of the Value-Added Tax on taxable sale of real property is "GROSS SELLING PRICE" which is either selling price stated in the sale document or the "Zonal Value", whichever is higher. In the absence of zonal values, the gross selling price shall refer to the market value as shown in the latest tax declaration or the consideration, whichever is higher.

### VAT: Characteristics of VAT (1996)

***What are the characteristics of the Value-Added Tax?***

**SUGGESTED ANSWER:**

The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services.

**ALTERNATIVE ANSWER:**

The value-added tax has the following characteristics:

1) It is an indirect tax where tax shifting is always presumed:
2) It is consumption-based;
3) It is imposed on the value-added in each stage of distribution;
4) It is a credit-invoice method value-added tax; and
5) It is not a cascading tax.

### VAT: Exempted Transactions (1996)

Give at least three (3) real estate transactions which are not subject to the Value-Added Tax.

**SUGGESTED ANSWER:**

Real estate transactions which are exempt from the value-added tax are:

(a) Sale of real property not primarily held for sale or lease in the ordinary course of trade or business;

(b) Sale of real property utilized for socialized housing under RA. No. 7279;
(c) Sale of real property utilized under the low-cost housing under BP Big. 220.

**Note:** The other real estate transactions which are exempt from the value-added tax which may be cited by the bar candidates are as follows:

(a) Transfer of real property to a trustee if the property is to be held merely in trust for the trustor.
(b) Transfer of real property to a corporation in exchange for its shares of stock under Section 34(c)(2) and (6)(2) of the Tax Code.
(c) Advance payment by the lessee in a lease contract, when the same is actually a loan to the lessor from the lessee.
(d) Security deposits for lease arrangements to insure the faithful performance of certain obligations of the lessee to the lessor.
(e) Lease of residential units, boarding houses, dormitories, rooms and bed spaces offered for rent by their owners at a monthly rental not exceeding P3,950.00 per unit.

### VAT: Liable for Payment (1996)

***Who are liable for the payment of Value-Added Tax?***

**SUGGESTED ANSWER:**

The persons liable for the value-added tax are:

a. Sellers of goods and properties in the course of trade or business;

b. Sellers of services in the course of trade or business, including lessors of goods and properties;

c. Importers of taxable goods, whether in the course of business or not

### VAT: Transactions "Deemed Sales" (1997)

Under the Value Added tax (VAT), the tax is imposed on sales, barter, or exchange of goods and services. The VAT is also imposed on certain transactions "deemed-sales". What are these so-called transactions "deemed sales'?

**SUGGESTED ANSWER:**

The following transactions shall be deemed sale:

a) Transfer, use, or consumption not in the course of business of goods originally intended for sale or for use in the course of business;

b) Distribution or transfer to:
   (1) Shareholders or investors as share in the profits of VAT-registered persons; or
   (2) Creditors in payment of debt;

c) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned; and

d) Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation.

### VAT; Covered Transactions (1998)

State whether the following transactions are a) VAT Exempt, b) subject to VAT at 10%; or c) subject to VAT at 0%:

1) Sale of fresh vegetables by Aling Ining at the Pamilihang Bayan ng Trece Martirez. [1%]
2) Services rendered by Jake's Construction Company, a contractor to the World Health Organization in the renovation of its offices in Manila. [1%]
3) Sale of tractors and other agricultural implements by Bungkal Incorporated to local farmers. [1%]
4) Sale of RTW by Cely's Boutique, a Filipino dress designer, in her dress shop and other outlets. [1%]
5) Fees for lodging paid by students to Bahay-Bahayan Dormitory, a private entity operating a student dormitory (monthly fee PI,500). [1%]

**SUGGESTED ANSWER:**

1) VAT exempt. Sale of agricultural products, such as fresh vegetables, in their original state, of a kind generally used as, or producing foods for human consumption is exempt from VAT. (Section 109(c), NIRC).

2) VAT at 0%. Since Jake's Construction Company has rendered services to the World Health Organization, which is an entity exempted from taxation under international agreements to which the Philippines is a signatory, the supply of services is subject to zero percent (0%) rate. (Sec. 108[B1(3), NIRC).

3) VAT at 10%. Tractors and other agricultural implements fall under the definition of goods which include all tangible objects which are capable of pecuniary estimation (Sec. 106[A1(1), NIRC, the sales of which are subject to VAT at 10%.

4) This is subject to VAT at 10%. This transaction also falls under the definition of goods which include all tangible objects which are capable of pecuniary estimation (Sec. 106[A1(1), NIRC, the sales of which are subject to VAT at 10%.

5) VAT Exempt. The monthly fee paid by each student falls under the lease of residential units with a monthly rental per unit not exceeding Php 8,000, which Is exempt from VAT regardless of the amount of aggregate rentals received by the lessor during the year. (Sec. 109(x), NIRC). The term unit shall mean per person in the case of dormitories, boarding houses and bed spaces (Sec. 4.103-1, RRNo. 7-95).

**COMMENT:** The problems do not call for a yes or no answer. Accordingly, a bar candidate who answered only VAT exempt. VAT at 10% or VAT at 0%. as called for in the problem without further reasons, should be given full credit.

### VAT; Exemption: Constitutionality (2004)

A law was passed exempting doctors and lawyers from the operation of the value added tax. Other professionals complained and filed a suit questioning the law for being discriminatory and violative of the equal protection clause of the Constitution since complainants were not given the

same exemption. Is the suit meritorious or not? Reason briefly. (5%)

**SUGGESTED ANSWER:**

B. Yes, the suit is meritorious. The VAT is designed for economic efficiency; hence, should be neutral to those who belong to the same class. Professionals are a class of taxpayers by themselves who, in compliance with the rule of equality of taxation, must be treated alike for tax purposes. Exempting lawyers and doctors from a burden to which other professionals are subjected will make the law discriminatory and violative of the equal protection clause of the Constitution. While singling out a class for taxation purposes will not infringe upon this constitutional limitation (***Shell v. Vano, 94 Phil. 389 [1954]***), singling out a taxpayer from a class will no doubt transgress the constitutional limitation (***Ormoc Sugar Co. Inc., v. Treasurer of Ormoc City, 22 SCRA 603 [1968***]). Treating doctors and lawyers as a different class of professionals will not comply with the requirements of a reasonable, hence valid classification, because the classification is not based upon substantial distinction which makes real differences. The classification does not comply with the requirement that it should be germane to the purpose of the law either. (***Pepsi-Cola Bottling Co., Inc. v. City of Butuan, 24 SCRA 789 [1968]***).

**ANOTHER ANSWER:**

No. The suit is not meritorious. The equal protection clause of the Constitution merely requires that all persons subjected to legislation shall be treated alike, under like circumstances and conditions, both in the privileges conferred and in the liabilities imposed. The equality in taxation rule is not violated if classifications or distinctions are made as long as the same are based on reasonable and substantial differences. {***Pepsi-Cola Bottling Co., Inc. v. City of Butuan, 24 SCRA 789 [1968***]).

In the instant case, the professions of doctors and lawyers are not principally aimed at earning money but for the service of the people. The exemption granted to doctors and lawyers from the operation of the VAT is justified, as it is not discriminatory against the other professionals because they have reasonable and substantial differences in the conduct of their professions.

### VAT; Non-VAT taxpayer; Claim for Refund (2006)

Lily's Fashion, Inc. is a garment manufacturer located and registered as a Subic Bay Freeport Enterprise under Republic Act No. 7227 and a non-VAT taxpayer. As such, it is exempt from payment of all local and national internal revenue taxes. During its operations, it purchased various supplies and materials necessary in the conduct of its manufacturing business. The suppliers of these goods shifted to Lily's Fashion, Inc. the 10% VAT on the purchased items amounting to P 500,000.00. Lily's Fashion, Inc. filed with the BIR a claim for refund for the input tax shifted to it by the suppliers. If you were the Commissioner of Internal Revenue, will you allow the refund? (5%)

**ALTERNATIVE ANSWER:**

No, I will not allow the refund. Only VAT-Registered taxpayers are entitled to a refund of their unapplied/unused Input VAT (Tax Reform Act, Section 112[A] [1997]).

**ALTERNATIVE ANSWER:**

No. The exemption of Lily's Fashion, Inc. is only for taxes for which it is directly liable. Hence, it can not claim exemption for a tax shifted to it, which is not at all considered a tax to the buyer but a part of the purchase price. Lily's fashion is not the taxpayer in so far as the passed-on tax is concerned and therefore, it can not claim for a refund of a tax merely shifted to it (Phil. Acetylene Co., Inc. v. CIR, L-19707,Aug. 17, 1987).

*(NOTA BENE: This concept pertains to the VAT law which is excluded from the Bar coverage, Guidelines for 2006 Bar Examinations, June 15, 2006)*

## REMEDIES IN INTERNAL REVENUE TAXES

### BIR: Assessment: Unregistered Partnership (1997)

Mr. Santos died intestate in 1989 leaving his spouse and five children as the only heirs. The estate consisted of a family home and a four-door apartment which was being rented to tenants. Within the year, an extrajudicial settlement of the estate was executed from the heirs, each of them receiving his/her due share. The surviving spouse assumed administration of the property. Each year, the net income from the rental property was distributed to all, proportionately, on which they paid respectively, the corresponding income tax.

In 1994, the income tax returns of the heirs were examined and deficiency income tax assessments were issued against each of them for the years 1989 to 1993, inclusive, as having entered into an unregistered partnership. Were the assessments justified?

**SUGGESTED ANSWER:**

Yes, the assessments were justified because for income tax purposes, the co-ownership of inherited property is automatically converted into an unregistered partnership from the moment the said properties are used as a common fund with intent to produce profits for the heirs in proportion to their shares in the inheritance.

From the moment of such partition, the heirs are entitled already to their respective definite shares of the estate and the income thereof, for each of them to manage and dispose of as exclusively his own without the intervention of the other heirs, and, accordingly, he becomes liable individually for all taxes in connection therewith. If after such partition, he allows his shares to be held in common with his co-heir under a single management to be used with the intent of making profit thereby in proportion to his share, there can be no doubt that, even if no document or instrument were executed for the purpose, for tax purposes, at least, an unregistered partnership is formed (***Lorenzo Ona, et al v. CIR, 45 SCRA 74***).

**ALTERNATIVE ANSWER:**

No, the assessments are not justified. The mere sharing of income does not of itself establish a partnership absent any clear intention of the co-owners who are only awaiting liquidation of the estate.

### BIR: Collection of Tax Deficiency (1999)

A died, survived by his wife and three children. The estate tax was properly paid and the estate settled and divided and distributed among the four heirs. Later, the BIR found out that the estate failed to report the income received by the estate during administration. The BIR issued a deficiency income tax assessment plus interest, surcharges and penalties. Since the 3 children are residing abroad, the BIR sought to collect the full tax deficiency only against the widow. Is the BIR correct? (10%)

**SUGGESTED ANSWER:**

Yes, the BIR is correct. In a case where the estate has been distributed to the heirs, the collection remedies available to the BIR in collecting tax liabilities of an estate may either (1) sue all the heirs and collect from each of them the amount of tax proportionate to the inheritance received or (2) by virtue of the lien created under Section 219, sue only one heir and subject the property he received from the estate to the payment of the estate tax. The BIR, therefore, is correct in pursuing the second remedy although this will give rise to the right of the heir who pays to seek reimbursement from the other heirs. ***(CIR v. Pineda, 21 SCRA 105).*** In no case, however, can the BIR enforce the tax liability in excess of the share of the widow in the inheritance.

### BIR: Compromise; Conditions (2000)

Under what conditions may the Commissioner of Internal Revenue be authorized to:

**A.** Compromise the payment of any internal revenue tax? (2%)

**SUGGESTED ANSWER:**

The Commissioner of Internal Revenue may be authorized to compromise the payment of any internal revenue tax where:

1) A reasonable doubt as to the validity of the claim against the taxpayer exists; or
2) the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax.

**B.** Abate or cancel a tax liability? (3%)

**SUGGESTED ANSWER:**

The Commissioner of Internal Revenue may abate or cancel a tax liability when:

1) The tax or any portion thereof appears to be unjustly or excessively assessed; or
2) The administration and collection costs involved do not justify the collection of the amount due. [Sec. 204 (B), NIRC of 1997]

### BIR: Compromise; Extent of Authority (1996)

Explain the extent of the authority of the Commissioner of Internal Revenue to compromise and abate taxes?

**SUGGESTED ANSWER:**

The authority of the Commissioner to compromise encompasses both civil and criminal liabilities of the taxpayer. The civil compromise is allowed only in cases

12) where the tax assessment is of doubtful validity, or
13) when the financial position of the taxpayer demonstrates a clear inability to pay the tax.

The compromise of the tax liability is possible at any stage of litigation and the amount of compromise is left to the discretion of the Commissioner except with respect to final assessments issued against large taxpayers wherein the Commissioner cannot compromise for less than fifty percent (50%). Any compromise involving large taxpayers lower than fifty percent (50%) shall be subject to the approval of the Secretary of Finance.

All criminal violations except those involving fraud, can be compromised by the Commissioner but only prior to the filing of the information with the Court. The Commissioner may also abate or cancel a tax liability when

1. the tax or any portion thereof appears to have been unjustly or excessively assessed; or
2. the administrative and collection costs involved do not Justify collection of the amount due. (Sec. 204, NIRC)

### BIR: Compromise; Withholding Agent (1998)

May the Commissioner of the Internal Revenue compromise the payment of withholding tax *(tax deducted and withheld at source)* where the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax? [5%1

**SUGGESTED ANSWER:**

No. A taxpayer who is constituted as withholding agent who has deducted and withheld at source the tax on the income payment made by him holds the taxes as trust funds for the government (Sec. 58[D]) and is obligated to remit them to the BIR. The subsequent inability of the withholding agent to pay/remit the tax withheld is not a ground for compromise because the withholding tax is not a tax upon the withholding agent but it is only a procedure for the collection of a tax.

### BIR: Corporation: Distraint & Levy (2002)

On March 15, 2000, the BIR issued a deficiency income tax assessment for the taxable year 1997 against the Valera Group of Companies (Valera) in the amount of P10 million. Counsel for Valera protested the assessment and requested a reinvestigation of the case. During the investigation, it was shown that Valera had been transferring its properties to other persons. As no additional evidence to dispute the assessment had been presented, the BIR issued on June 16, 2000 warrants of distraint and levy on the properties and ordered the filing of an action in the Regional Trial Court for the collection of the tax. Counsel for Valera filed an injunctive suit in the Regional Trial Court to compel the BIR to hold the collection of the tax in abeyance until the decision on the protest was rendered.

A. Can the BIR file the civil action for collection, pending decision on the administrative protest? Explain. (3%)

**SUGGESTED ANSWER:**

A. Yes, because there is no prohibition for this procedure considering that the filing of a civil action for collection during the pendency of an administrative protest constitutes the final decision of the Commissioner on the protest (***CIR v. Union Shipping Corp., 85 SCRA 548 [1990]***).

B. As counsel for Valera, what action would you take in order to protect the interest of your client? Explain your answer. (2%)

**SUGGESTED ANSWER:**

B. I will wait for the filing of the civil action for collection and consider the same as an appealable decision. I will not file an injunctive suit because it is not an available remedy. I would then appeal the case to the Court of Tax Appeals and move for the dismissal of the collection case with the RTC. Once the appeal to the CTA is filed on time, the CTA has exclusive jurisdiction over the case. Hence, the collection case in the RTC should be dismissed (***Tabes v. Flojo, 115 SCRA 278 [1982]***).

### BIR: Court of Tax Appeals: Collection of Taxes; Grounds for Compromise (1996)

1. May the Court of Tax Appeals issue an injunction to enjoin the collection of taxes by the Bureau of Internal Revenue? Explain.

**SUGGESTED ANSWER:**

Yes. When a decision of the Commissioner on a tax protest is appealed to the CTA pursuant to *Sec. 11 of RA. No. 1125 (law creating the CTA) in relation to Sec. 229 of the NIRC*, such appeal does not suspend the payment, levy, distraint and/or sale of any of the taxpayer's property for the satisfaction of his tax liability. However, when in the opinion of the CTA the collection of the tax may jeopardize the interest of the Government and/or the taxpayer, the Court at any stage of the proceedings may suspend or restrain the collection of the tax and require the taxpayer either to deposit the amount claimed or to file a surety bond for not more than double the amount with the Court.

2. May the tax liability of a taxpayer be compromised during the pendency of an appeal? Explain.

**SUGGESTED ANSWER:**

Yes. During the pendency of the appeal, the taxpayer may still enter into a compromise settlement of his tax liability for as long as any of the grounds for a compromise i.e.; *doubtful validity of assessment* and *financial incapacity of taxpayer*, is present. A compromise of a tax liability is possible at any stage of litigation, even during appeal, although legal propriety demands that prior leave of court should be obtained (***Pasudeco vs. CIR L-39387, June 29, 1982***).

### BIR: Criminal Prosecution: Tax Evasion (1998)

Is assessment necessary before a taxpayer may be prosecuted for willfully attempting in any manner to evade or defeat any tax imposed by the Internal Revenue Code? [5%)

**SUGGESTED ANSWER:**

No. Assessment is not necessary before a taxpayer maybe prosecuted if there is a prima facie showing of a willful attempt to evade taxes as in the taxpayer's failure to declare a specific item of taxable income in his income tax returns (***Ungab v. Cusi 97 SCRA 877***). On the contrary, if the taxes alleged to have been evaded is computed based on reports approved by the BIR there is a presumption of regularity of the previous payment of taxes, so that unless and until the BIR has made a final determination of what is supposed to be the correct taxes, the taxpayer should not be placed in the crucible of criminal prosecution (***CIR v. Fortune Tobacco Corp., GR No. 119322, June 4, 1996***).

### BIR: Extinction; Criminal Liability of the Taxpayer (2002)

Mr. Chan, a manufacturer of garments, was investigated for failure to file tax returns and to pay taxes for the taxable year 1997. Despite the *subpoena duces tecum* issued to him, he refused to present and submit his books of accounts and allied records. Investigators, therefore, raided his factory and seized several bundles of manufactured garments, supplies and unpaid imported textile materials. After his apprehension and based on the testimony of a former employee, deficiency income and business taxes were assessed against Mr. Chan on April 15, 2000. It was then that he paid the taxes. Criminal action was nonetheless instituted against him in the Regional Trial Court for violation of the Tax Code. Mr. Chan moved to dismiss the criminal case on the ground that he had already paid the taxes assessed against him. He also demanded the return of the garments and materials seized from his factory. How will you resolve Mr. Chan's motion? (5%)

**SUGGESTED ANSWER:**

The motion to dismiss should be denied. The satisfaction of the civil liability is not one of the grounds for the extinction of criminal action (***People v. Ildefonso Tierra, 12 SCRA 666 [1964]***). Likewise, the payment of the tax due after apprehension shall not constitute a valid defense in any prosecution for violation of any provision of the Tax Code (Sec. 253[a], NIRC). However, the garments and materials seized from the factory should be ordered returned because the payment of the tax had released them from any lien that the Government has over them.

### Customs; Jurisdiction; Assessment; Unpaid Customs Duties/Taxes (2006)

The Collector of Customs issued an assessment for un-paid customs duties and taxes on the importation of your client in the amount of P980,000.00. Where will you file your case to protect your client's right? Choose the correct courts/ agencies, observing their proper hierarchy. (5%)

1. Court of Tax Appeals
2. Collector of Customs
3. Commissioner of Customs
4. Regional Trial Court
5. Metropolitan Trial Court
6. Court of Appeals
7. Supreme Court

**SUGGESTED ANSWER:**

1. Protest with the Collector of Customs *(Sec. 2308, TCC)*
2. Appeal to the Commissioner of Customs *(Sec. 2313, TCC).*
3. Appeal to the CTA *(RA 9282)*
4. Petition for Review on Certiorari Supreme Court *(Rule 45 of the 1997 Rules of Civil Procedure (RA 9282).*

### Taxpayer; Prescriptive Period; Assessment; Deficiency Income Tax (2006)

The Commissioner of Internal Revenue issued an assessment for deficiency income tax for taxable year 2000 last July 31, 2006 in the amount of P 10 Million inclusive of

surcharge and interests. If the delinquent taxpayer is your client, what steps will you take? What is your defense? (10%)

**ALTERNATIVE ANSWER:**

As Counsel, I shall move to cancel the Assessment because of prescription. The three (3) year period of assessment for the Income Tax Returns of 2000 starts on April 15, 2001 and ends on April 16, 2004. The assessment of July 31, 2006 is beyond the three (3) year prescriptive period and can no longer have any legal, binding effect *(Tax Reform Act, Title VIII, Chapter I, Section 203 [1997])*.

**ALTERNATIVE ANSWER:**

Since my client has lost his right to protest, I will advise him to wait for a collection action by the Commissioner. Then, I will file a petition for review with the CTA to question the collection. Since the assessment was issued beyond the prescriptive period to assess, the action to collect an invalid assessment is not warranted ***(Phil. Journalists, Inc. v. CIR, G.R. No. 162852, December 16, 2004).***

### Taxpayer; Assessment; Deficiency Tax (2006)

On June 1, 2003, Global Bank received a final notice of assessment from the BIR for deficiency documentary stamp tax in the amount of P5 Million. On June 30, 2003, Global Bank filed a request for reconsideration with the Commissioner of Internal Revenue. The Commissioner denied the request for reconsideration only on May 30, 2006, at the same time serving on Global Bank a warrant of distraint to collect the deficiency tax. If you were its counsel, what will be your advice to the bank? Explain. (5%)

**ALTERNATIVE ANSWER:**

The denial for the request for reconsideration is the final decision of the CIR.. I would advise Global Bank to appeal the denial to the Court of Tax Appeals (CTA) within 30 days from receipt. I will further advise the bank to file a motion for injunction with the Court of Tax Appeals to enjoin the Commissioner from enforcing the assessment pending resolution of the appeal. While an appeal to the CTA will not suspend the payment, levy, distraint, and/or sale of any property of the taxpayer for the satisfaction of its tax liability, the CTA is authorized to give injunctive relief if the enforcement would jeopardize the interest of the taxpayer, as in this case, where the assessment has not become final ***(Lascona Land Co. v, CIR, CTA Case No. 5777, January 4, 2000; See also Revised CTA Rules, approved by the Supreme Court on December 15, 2005).***

**ALTERNATIVE ANSWER:**

I will advice the Bank to promptly pay the deficiency documentary stamp tax and the interest charges to avoid any further increase in the tax liability. The Bank should have appealed to the Court of Tax Appeals when the BIR failed to decide on its Request for Reconsideration within thirty (30) days after the inaction of the BIR for one hundred eighty (180) days or on December 31, 2003. The Tax Assessment has already become final, executory and unappealable at that point ***(BPI v. CIR, G.R. No. 139736, October 17, 2005).***

### Taxpayer; VAT-registered; Claim for Tax Refund (2006)

Royal Mining is a VAT-registered domestic mining entity. One of its products is silver being sold to the Bangko Sentral ng Pilipinas. It filed a claim with the BIR for tax refund on the ground that under Section 106 of the Tax Code, sales of precious metals to the Bangko Sentral ng Pilipinas are considered export sales subject to zero-rated VAT. Is Royal Mining's claim meritorious? Explain. (5%)

**SUGGESTED ANSWER:**

No, Royal Mining's claim is not meritorious because it is the sale to the Bangko Sentral ng Pilipinas of gold and not silver which is considered export sales at Zero-rated VAT *(Tax Reform Act, Title IV, Section 106[2][a][4])*.

*(**NOTA BENE**: EVAT is excluded from the Bar coverage, Guidelines for 2006 Bar Examinations, June 15, 2006)*

### BIR: Fraudulent Return; Prima Facie Evidence (1998)

What constitutes prima facie evidence of a false or fraudulent return? [2%]

**SUGGESTED ANSWER:**

There is prima facie evidence of a false or fraudulent return when the taxpayer has willfully and knowingly filed it with the intent to evade a part or all of the tax legally due from him (***Ungab v. Cusi,, 97 SCRA 877***). There must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence. A mistake not culpable in respect of its value would not constitute a false return. *(Words and Phrases, Vol. 16, page 173)*.

### BIR: Fraudulent Return; Prima Facie Evidence (2002)

What constitutes *prima facie* evidence of a false or fraudulent return to justify the imposition of a 50% surcharge on the deficiency tax due from a taxpayer? Explain. (5%)

**SUGGESTED ANSWER:**

There is a prima facie evidence of false or fraudulent return when the taxpayer *SUBSTANTIALLY UNDER-DECLARED* his taxable sales, receipts or income, or *SUBSTANTIALLY OVERSTATED* his deductions, the taxpayer's failure to report sales, receipts or income in an amount exceeding 30% of that declared per return, and a claim of deduction in an amount exceeding 30% of actual deduction shall render the taxpayer liable for substantial underdeclaration and overdeclaration, respectively, and will justify the imposition of the 50% surcharge on the deficiency tax due from the taxpayer. *(Sec. 248, NIRC)*.

### BIR: Garnishment: Bank Account of a Taxpayer (1998)

Is the BIR authorized to issue a warrant of garnishment against the bank account of a taxpayer despite the pendency of his protest against the assessment with the BIR or appeal with the Court of Tax Appeals? [5%]

**SUGGESTED ANSWER:**

The BIR is authorized to issue a warrant of garnishment against the bank account of a taxpayer despite the pendency of protest (***Yabes v. Flojo, 15 SCRA 278***). Nowhere in the Tax Code is the Commissioner required to rule first on the protest before he can institute collection proceedings on the tax assessed. The legislative policy is to give the Commissioner much latitude in the speedy and prompt collection of taxes because it is in taxation that the Government depends to obtain the

means to carry on its operations (***Republic u. Tim Tian Teng Sons, Inc., 16 SCRA 584***).

**ALTERNATIVE ANSWER:**

No, because the assessment has not yet become final, executory and demandable. The basic consideration in the collection of taxes is whether the assessment is final and unappealable or the decision of the Commissioner is final, executory and demandable, the BIR has legal basis to collect the tax liability by either administrative or judicial action.

### BIR: Pre-Assessment Notice not Necessary (2002)

In the investigation of the withholding tax returns of AZ Medina Security Agency (AZ Medina) for the taxable years 1997 and 1998, a discrepancy between the taxes withheld from its employees and the amounts actually remitted to the government was found. Accordingly, before the period of prescription commenced to run, the BIR issued an assessment and a demand letter calling for the immediate payment of the deficiency withholding taxes in the total amount of P250,000.00. Counsel for AZ Medina protested the assessment for being null and void on the ground that no pre-assessment notice had been issued. However, the protest was denied. Counsel then filed a petition for prohibition with the Court of Tax Appeals to restrain the collection of the tax.

A. Is the contention of the counsel tenable? Explain (2%)

**SUGGESTED ANSWER:**

A. No, the contention of the counsel is untenable. Section 228 of the Tax Code expressly provides that no pre-assessment notice is required when a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent. Since the amount assessed relates to deficiency withholding taxes, the BIR is correct in issuing the assessment and demand letter calling for the immediate payment of the deficiency withholding taxes. (Sec. 228, NIRC).

B. Will the special civil action for prohibition brought before the CTA under Sec. 11 of R.A, No. 1125 prosper? Discuss your answer. (3%)

**SUGGESTED ANSWER:**

B. The special civil action for prohibition will not prosper, because the CTA has no jurisdiction to entertain the same. The power to issue writ of injunction provided for under Section 11 of RA 1125 is only ancillary to its appellate jurisdiction. The CTA is not vested with original jurisdiction to issue writs of prohibition or injunction independently of and apart from an appealed case. The remedy is to appeal the decision of the BIR. (***Collector v. Yuseco, 3 SCRA 313 [1961]***).

### BIR: Prescriptive Period: Civil Action (2002)

On August 5, 1997, Adamson Co., Inc. (Adamson) filed a request for reconsideration of the deficiency withholding tax assessment on July 10, 1997, covering the taxable year 1994. After administrative hearings, the original assessment of P150,000.00 was reduced to P75.000.00 and a modified assessment was thereafter issued on August 05, 1999. Despite repeated demands, Adamson failed and refused to pay the modified assessment. Consequently, the BIR brought an action for collection in the Regional Trial Court on September 15, 2000. Adamson moved to dismiss the action on the ground that the government's right to collect the tax by judicial action has prescribed. Decide the case. (5%)

**SUGGESTED ANSWER:**

The right of the Government to collect by judicial action has not prescribed. The filing of the request for reconsideration suspended the running of the prescriptive period and commenced to run again when a decision on the protest was made on August 5, 1999. It must be noted that in all cases covered by an assessment, the period to collect shall be five (5) years from the date of the assessment but this period is suspended by the filing of a request for reconsideration which was acted upon by the Commissioner of Internal Revenue (***CIR v. Wyeth Suaco Laboratories, Inc., 202 SCRA 125 [1991]***).

### BIR: Prescriptive Period; Assessment & Collection (1999)

A Co., a Philippine Corporation, filed its 1995 Income Tax Return (ITR) on April 15, 1996 showing a net loss. On November 10, 1996, it amended its 1995 ITR to show more losses. After a tax investigation, the BIR disallowed certain deductions claimed by A Co., putting A Co. in a net income position. As a result, on August 5, 1999, the BIR issued a deficiency income assessment against A Co. A Co. protested the assessment on the ground that it has prescribed: Decide. (5%)

**SUGGESTED ANSWER:**

The right of the BIR to assess the tax has not prescribed. *The rule is that internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return.* (*Section 203, NIRC*), However, if the return originally filed is amended substantially, the counting of the three-year period starts from the date the amended return was filed. (***CIR v. Phoenix Assurance Co., Ltd., 14 SCRA 52***). There is a substantial amendment in this case because a new return was filed declaring more losses, which can only be done either (1) in reducing gross income or (2) in increasing the items of deductions, claimed.

### BIR: Prescriptive Period; Criminal Action (2002)

TY Corporation filed its final adjusted income tax return for 1993 on April 12, 1994 showing a net loss from operations. After investigation, the BIR issued a pre-assessment notice on March 30, 1996. A final notice and demand letter dated April 15, 1997 was issued, personally delivered to and received by the company's chief accountant. For willful refusal and failure of TY Corporation to pay the tax, warrants of distraint and levy on its properties were issued and served upon it. On January 10, 2002, a criminal charge for violation of the Tax Code was instituted in the Regional Trial Court with the approval of the Commissioner.

The company moved to dismiss the criminal complaint on the ground that an act for violation of any provision of the Tax Code prescribes after five (5) years and, in this case, the period commenced to run on March 30, 1996 when the pre-assessment was issued. How will you resolve the motion? Explain your answer. (5%)

**SUGGESTED ANSWER:**
The motion to dismiss should not be granted. It is only when the assessment has become final and unappealable that the 5-year period to file a criminal action commences to run (***Tupaz v. Ulop, 316 SCRA 118 [1999]***). The pre-assessment notice issued on March 30, 1996 is not a final assessment which is enforceable by the BIR. It is the issuance of the final notice and demand letter dated April 15, 1997 and the failure of the taxpayer to protest within 30 days from receipt thereof that made the assessment final and unappealable. The earliest date that the assessment has become final is May 16, 1997 and since the criminal charge was instituted on January 10, 2002, the same was timely filed.

### BIR: Secrecy of Bank Deposits Law (1998)

Can the Commissioner of Internal Revenue inquire into the bank deposits of a taxpayer? If so, does this power of the Commissioner conflict with R.A. 1405 (Secrecy of Bank Deposits Law) [5%]

**SUGGESTED ANSWER:**
The Commissioner of Internal Revenue is authorized to inquire into the bank deposits of:

1) a decedent to determine his gross estate;

2) any taxpayer who has filed an application for compromise of his tax liability by means of financial incapacity to pay his tax liability (Sec. 6(F). NIRC).

*3)* Where the taxpayer has signed a waiver authorizing the Commissioner or his duly authorized representatives to Inquire into the bank deposits. *(Note: This answer was not part of the answers enumerated in the UP Law Answers to the Bar in this but was later added in the recent UP Law Answers to the Bar as a result of AMLA Law of 2001)*

The limited power of the Commissioner does not conflict with R.A. No. 1405 because the provisions of the Tax Code granting this power is an exception to the Secrecy of Bank Deposits Law as embodied in a later legislation.

Furthermore, in case a taxpayer applies for an application to compromise the payment of his tax liabilities on his claim that his financial position demonstrates a clear inability to pay the tax assessed, his application shall not be considered unless and until he waives in writing his privilege under R.A. No. 1405, and such waiver shall constitute the authority of the Commissioner to inquire into the bank deposits of the taxpayer.

### BIR; Consequence; Taxpayer guilty of Tax Evasion (2005)

Josel agreed to sell his condominium unit to Jess for P2.5 Million. At the time of the sale, the property had a zonal value of P2.0 Million. Upon the advice of a tax consultant, the parties agreed to execute two deeds of sale, one indicating the zonal value of P2.0 Million as the selling price and the other showing the true selling price of P2.5 Million. The tax consultant filed the capital gains tax return using the deed of sale showing the zonal value of P2.0 Million as the selling price. Discuss the tax implications and consequences of the action. (5%)

**ALTERNATIVE ANSWER:**
The action of the parties constitutes tax evasion and exposes Josel to:

(1) DEFICIENCY FINAL INCOME TAX on the sale of real property in the Philippines classified as a capital asset. Under Sec. 24(D) of the NIRC, the final tax of six percent (6%) shall be based on the gross selling price of P2.5 Million or zonal value of P2.0 Million, whichever is higher, i.e., P2.5 Million;
(2) FRAUD PENALTY amounting to 50% surcharge on the amount evaded (Sec. 248[B] NIRC); and
(3) DEFICIENCY INTEREST of 20% per annum on the deficiency. (Sec. 249[A][B], NIRC)

**ALTERNATIVE ANSWER:**
There is tax evasion because of the concurrence of the following factors:

1) The payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due. It is evident that the parties that the tax due should be computed based on the valuation of P2.5 million and not P2.0 million;

2) An accompanying state of mind which is described as being "evil" on "bad faith," "willful," or "deliberate and not accidental." Despite the above knowledge, the parties deliberately misrepresented the true basis of the sale; and

3) A course of action or failure of action which is unlawful. This is shown by the preparation of the two deeds of sale which showed different values. ***(Commissioner of Internal Revenue v. The Estate ofBenigno P, Tbda, Jr., G.R. No. 147188, September 14, 2004)***

The tax evasion committed should result to the imposition of a 50% fraud surcharge on the amount evaded *(Sec. 248[B], NIRC)* payment of the Deficiency Tax, and interest of 20% per annum on the deficiency. *(Sec. 249[A][B], NIRC)* The parties may likewise be subject to criminal prosecution for willfully failing to pay the tax, as well as for filing a false and fraudulent return. *(Sees. 254, 255 and 257, NIRC)*

### BIR: Summary Remedy: Estate Tax Deficiencies (1998)

Is the BIR authorized to collect estate tax deficiencies by the summary remedy of levy upon and sale of real properties of the decedent without first securing the authority of the court sitting in probate over the supposed will of the decedent?

**SUGGESTED ANSWER:**
Yes. The BIR is authorized to collect estate tax deficiency through the summary remedy of levying upon and sale of real properties of a decedent, without the cognition and authority of the court sitting in probate over the supposed will of the deceased, because the collection of estate tax is executive in character. As such the estate tax is exempted from the application of the statute of non-claims, and this is justified by the necessity of government funding, immortalized in the maxim that taxes are the lifeblood of the government (***Marcos v. CIR, G.R. No. 120880, June 5, 1997***).

**ALTERNATIVE ANSWER:**

Yes, if the tax assessment has already become final, executory and enforceable. The approval of the court sitting in probate over the supposed will of the deceased is not a mandatory requirement for the collection of the estate tax. The probate court is determining issues which are not against the property of the decedent, or a claim against the estate as such, but is against the interest or property right which the heir, legatee, devisee, etc. has in the property formerly held by the decedent. (***Marcos v. CIR, G.R, No. 120880, June 5, 199***).

### BIR: Unpaid Taxes vs. Claims for Unpaid Wages (1995)

For failure of Oceanic Company, Inc. (OCEANIC), to pay deficiency taxes of P20 Million, the Commissioner of Internal Revenue issued warrants of distraint on OCEANIC's personal properties and levied on its real properties. Meanwhile, the Department of Labor through the Labor Arbiter rendered a decision ordering OCEANIC to pay unpaid wages and other benefits to its employees. Four barges belonging to OCEANIC were levied upon by the sheriff and later sold at public auction.

The Commissioner of Internal Revenue filed a motion with the Labor Arbiter to annul the sale and enjoin the sheriff from disposing the proceeds thereof. The employees of OCEANIC opposed the motion contending that Art. 110 of the Labor Code gives first preference to claims for unpaid wages.

Resolve the motion. Explain.

**SUGGESTED ANSWER:**

The motion filed by the Commissioner should be granted because the claim of the government for unpaid taxes are generally preferred over the claims of laborers for unpaid wages. The provision of Article 110 of the Labor Code, which gives laborers' claims for preference applies only in case of bankruptcy or liquidation of the employer's business. In the instant case, Oceanic is not under bankruptcy or liquidation at the time the warrants of distraint and levy were issued hence, the opposition of the employees is unwarranted. ***(CIR vs. NLRC et al G.R. No. 74965, November 9, 1994).***

### BIR; Assessment; Criminal Complaint (2005)

In 1995, the BIR filed before the Department of Justice (DOJ) a criminal complaint against a corporation and its officers for alleged evasion of taxes. The complaint was supported by a sworn statement of the BIR examiners showing the computation of the tax liabilities of the erring taxpayer. The corporation filed a motion to dismiss the criminal complaint on the ground that there has been, as yet, no assessment of its tax liability; hence, the criminal complaint was premature. The DOJ denied the motion on the ground that an assessment of the tax deficiency of the corporation is not a precondition to the filing of a criminal complaint and that in any event, the joint affidavit of the BIR examiners may be considered as an assessment of the tax liability of the corporation. Is the ruling of the DOJ correct? Explain. (5%)

**SUGGESTED ANSWER:**

The DOJ is correct in ruling that an assessment of the tax deficiency of the corporation is not a precondition to the filing of a criminal complaint. There is no need for an assessment so long as there is a prima facie showing of violation of the provisions of the Tax Code. After all, a criminal charge is instituted not to demand payment, but to penalize the tax payer for violation of the Tax Code. ***(Commissioner of Internal Revenue v. Pascor Realty and Development Corporation, G.R. No. 128315, June 29, 1999***) Furthermore, there is nothing in the problem that shows that the BIR in filing the case is also interested in collecting the tax deficiency.

However, it is in error when it ruled that the joint affidavit of the BIR examiners may be considered as an assessment of the tax liability of the corporation. The joint affidavit showing the computation of the tax liabilities of the erring taxpayer is not a tax assessment because it was not sent to the taxpayer, and does not demand payment of the tax within a certain period of time. An assessment is deemed made only when the BIR releases, mails or sends such notice to the taxpayer. ***(Commissioner of Internal Revenue v. Pascor Realty and Development Corporation, G.R. No. 128315, June 29, 1999)***

> ***Notes and Comments:*** *A plea is made for liberality in correcting the examinees answers because the examination is very long.*

### BIR; Authority; Refund or Credit of Taxes (2005)

State the conditions required by the Tax Code before the Commissioner of Internal Revenue could authorize the refund or credit of taxes erroneously or illegally received.

**SUGGESTED ANSWER:**

Under Sec. 204(C), NIRC, the following conditions must be met:

1. There must be a written claim for refund filed by the taxpayer with the Commissioner.
2. The claim for refund must be a categorical demand for reimbursement.
3. The claim for refund must be filed within two (2) years from date of payment of the tax or penalty regardless of any supervening cause.

### BIR; Compromise (2004)

After the tax assessment had become final and unappealable, the Commissioner of Internal Revenue initiated the filing of a civil action to collect the tax due from NX. After several years, a decision was rendered by the court ordering NX to pay the tax due plus penalties and surcharges. The judgment became final and executory, but attempts to execute the judgment award were futile.

Subsequently, NX offered the Commissioner a compromise settlement of 50% of the judgment award, representing that this amount is all he could really afford. Does the Commissioner have the power to accept the compromise offer? Is it legal and ethical? Explain briefly. (5%)

**SUGGESTED ANSWER:**

Yes. The Commissioner has the power to accept the offer of compromise if the financial position of the taxpayer clearly demonstrates a clear inability to pay the tax (Section 204, NIRC).

As represented by NX in his offer, only 50% of the judgment award is all he could really afford. This is an offer for compromise based on financial incapacity which the Commissioner shall not accept unless accompanied by a waiver of the secrecy of bank deposits (Section 6[F}, NIRC). The waiver will enable the Commissioner to ascertain the financial position of the taxpayer, although the inquiry need not be limited only to the bank deposits of the taxpayer but also as to his financial position as reflected in his financial statements or other records upon which his property holdings can be ascertained.

If indeed, the financial position of NX as determined by the Commissioner demonstrates a clear inability to pay the tax, the acceptance of the offer is legal and ethical because the ground upon which the compromise was anchored is within the context of the law and the rate of compromise is well within and far exceeds the minimum prescribed by law which is only 10% of the basic tax assessed.

### BIR; Compromise (2005)

State and discuss briefly whether the following cases may be compromised or may not be compromised:

a) Delinquent accounts;
b) Cases under administrative protest, after issuance of the final assessment notice to the taxpayer, which are still pending;
c) Criminal tax fraud cases;
d) Criminal violations already filed in court;
e) Cases where final reports of reinvestigation or reconsideration have been issued resulting in the reduction of the original assessment agreed to by the taxpayer when he signed the required agreement form. (5%)

**SUGGESTED ANSWERS:**

The following cases may still be compromised *(R.R. 30-02 [2002])* because of the taxpayer's financial incapacity to pay the tax due or the assessment's doubtful validity:

a) DELINQUENT ACCOUNTS may be compromised because there is no showing that there is a duly-approved schedule of installment payments; and

b) Cases under administrative protest, after issuance of the final assessment notice to the taxpayer, which are still pending.

The following cases *MAY NO LONGER BE COMPR*OMISED *(R.R. 30-02 [2002])* because the taxpayer has not paid his taxes for reasons other than his financial incapacity or the doubtful validity of the assessment:

a) CRIMINAL TAX FRAUD cases as may be determined by the Commissioner or his authorized agents may not be compromised;

b) CRIMINAL VIOLATIONS ALREADY FILED IN COURT so that the taxpayer will not profit from his fraud which would encourage tax evasion; and

c) Cases where final reports of reinvestigation or reconsideration have been issued resulting in the reduction of the original assessment agreed to by the taxpayer when he signed the required agreement form. The taxpayer is estopped from applying for a compromise.

### BIR; Deficiency Tax Assessment vs. Tax Refund / Tax Credit (2005)

Is a deficiency tax assessment a bar to a claim for tax refund or tax credit? Explain.

**SUGGESTED ANSWER:**

Yes, the deficiency tax assessment is a bar to a tax refund or credit. The Taxpayer cannot be entitled to a refund and at the same time liable for a tax deficiency assessment for the same year. The deficiency assessment creates a doubt as to the truth and accuracy of the Tax Return. Said Return cannot therefore be the basis of the refund ***(Commissioner of Internal Revenue v. Alltel [2002], citing Commissioner of Internal Revenue v. Court of Appeals, City Trust Banking Corporation and Court of Tax Appeals, G.R. No. 106611, July 21, 1994)***

### BIR; Distraint; Prescription of the Action (2002)

Mr. Sebastian is a Filipino seaman employed by a Norwegian company which is engaged exclusively in international shipping. He and his wife, who manages their business, filed a joint income tax return for 1997 on March 15, 1998. After an audit of the return, the BIR issued on April 20, 2001 a deficiency income tax assessment for the sum of P250.000.00, inclusive of interest and penalty. For failure of Mr. and Mrs. Sebastian to pay the tax within the period stated in the notice of assessment, the BIR issued on August 19, 2001 warrants of distraint and levy to enforce collection of the tax.

A. What is the rule of income taxation with respect to Mr. Sebastian's income in 1997 as a seaman on board the Norwegian vessel engaged in international shipping? Explain your answer. (2%)

**SUGGESTED ANSWER:**

A. The income of Mr. Sebastian as a seaman is considered as income of a non-resident citizen derived from without the Philippines. The total gross income, in US dollars (or if in other foreign currency, its dollar equivalent) from without shall be declared by him for income tax purposes using a separate income tax return which will not include his income from business derived within (to be covered by another return). He is entitled to deduct from his dollar gross income a personal exemption of $4,500 and foreign national income taxes paid to arrive at his adjusted income during the year. His adjusted income will be subject to the graduated tax rates of 1% to 3%. *(Sec. 21 (b), Tax Code of 1986[PD 1158], as amended by PD 1994).*

[Note: The bar candidates are not expected to be familiar with tax history. Considering that this is already the fourth year of implementation of the Tax Code of 1997, bar candidates were taught and prepared to answer questions based on the present law. It is therefore requested that the examiner be more lenient in checking the answers to this question. Perhaps, an answer based on the present law be given full credit.]

B. If you are the lawyer of Mr. and Mrs. Sebastian, what possible defense or defenses will you raise in behalf of your clients against the action of the BIR in enforcing collection of the tax by the summary remedies of warrants of distraints and levy? Explain your answer. (3%)

**SUGGESTED ANSWER:**

B. I will raise the defense of prescription. The right of the BIR to assess prescribes after three years counted from the last day prescribed by law for the filing of the income tax returns when the said return is filed on time. (Section 203, NIRC). The last day for filing the 1997 income tax return is April 15, 1998. Since the assessment was issued only on April 20, 2001, the BIR's right to assess has already prescribed.

### BIR; False vs. Fraudulent Return (1996)

Distinguish a false return from a fraudulent return.

**SUGGESTED ANSWER:**

The distinction between a false return and a fraudulent return is that the first merely implies a deviation from the truth or fact whether intentional or not, whereas the second is intentional and deceitful with the sole aim of evading the correct tax due (***Aznar us. Commissioner, L-20569, August 23, 1974***).

**ALTERNATIVE ANSWER:**

A false return contains deviations from the truth which may be due to mistakes, carelessness or ignorance of the person preparing the return. A fraudulent return contains an intentional wrongdoing with the sole object of avoiding the tax and it may consist in the intentional underdeclaration of income, intentional overdeclaration of deductions or the recurrence of both. A false return is not necessarily tainted with fraud because the fraud contemplated by law is actual and not constructive. Any deviation from the truth on the other hand, whether intentional or not, constitutes falsity. (***Aznar vs. Commissioner, L-20569, August 23, 1974***)

### BIR; Jurisdiction; Review Rulings of the Commissioner (2006)

Mr. Abraham Eugenio, a pawnshop operator, after having been required by the Revenue District Officer to pay value added tax pursuant to a Revenue Memorandum Order (RMO) of the Commissioner of Internal Revenue, filed with the Regional Trial Court an action questioning the validity of the RMO. If you were the judge, will you dismiss the case? (5%)

**SUGGESTED ANSWER:**

Yes. The RMO is in reality a ruling of the Commissioner in implementing the provisions of the Tax Code on the taxability of pawnshops. Jurisdiction to review rulings of the Commissioner is lodged with the Court of Tax Appeals and not with the Regional Trial Court ***(CIR v. Josefina Leal, G.R. No. 113459, November 18, 2002; Tax Reform Act, RA 8424, Title I, Sec. 4 [1997]).***

> *(**NOTA BENE:** This concept pertains to the VAT law which is excluded from the bar coverage, Guidelines for 2006 Bar Examinations, June 15, 2006)*

### BIR; Prescriptive Period; Assessment; Fraudulent Return (2002)

Mr. Castro inherited from his father, who died on June 10, 1994, several pieces of real property in Metro Manila. The estate tax return was filed and the estate tax due in the amount of P250.000.00 was paid on December 06, 1994. The Tax Fraud Division of the BIR investigated the case on the basis of confidential information given by Mr. Santos on January 06, 1998 that the return filed by Mr. Castro was fraudulent and that he failed to declare all properties left by his father with intent to evade payment of the correct tax. As a result, a deficiency estate tax assessment for P1,250,000.00, inclusive of 50% surcharge for fraud, interest and penalty, was issued against him on January 10, 2001. Mr. Castro protested the assessment on the ground of prescription.

A. Decide Mr. Castro's protest. (2%)

**SUGGESTED ANSWER:**

A. The protest should be resolved against Mr. Castro. What was filed is a fraudulent return making the prescriptive period for assessment ten (10) years from discovery of the fraud (Section 222, NIRC). Accordingly, the assessment was issued within that prescriptive period to make an assessment based on a fraudulent return.

B. What legal requirement/s must Mr. Santos comply with so that he can claim his reward? Explain. (3%)

**SUGGESTED ANSWER:**

The legal requirements that must be complied by Mr. Santos to entitle him to reward are as follows:

1) He should voluntarily file a confidential information under oath with the Law Division of the Bureau of Internal Revenue alleging therein the specific violations constituting fraud;
2) The information must not yet be in the possession of the Bureau of Internal Revenue, or refer to a case already pending or previously investigated by the Bureau of Internal Revenue;
3) Mr. Santos should not be a government employee or a relative of a government employee within the sixth degree of consanguinity; and
4) The information must result to collections of revenues and/or fines and penalties. (Sec. 282, NIRC)

### BIR; Prescriptive Period; Criminal Action (2006)

Gerry was being prosecuted by the BIR for failure to pay his income tax liability for Calendar Year 1999 despite several demands by the BIR in 2002. The Information was filed with the RTC only last June 2006. Gerry filed a motion to quash the Information on the ground of prescription, the Information having been filed beyond the 5-year reglementary period. If you were the judge, will you dismiss the Information? Why? (5%)

**SUGGESTED ANSWER:**

No. The trial court can exercise jurisdiction. Prescription of a criminal action begins to run from the day of the violation of the law. The crime was committed when Gerry willfully refused to pay despite repeated demands in 2002. Since the information was filed in June 2006, the criminal case was instituted within the five-year period required by law ***(Tupaz v. Ulep, G.R. No. 127777, October 1, 1999; Section 281, NIRC).***

### BIR; Taxpayer: Civil Action & Criminal Action (2002)

Minolta Philippines, Inc. (Minolta) is an EPZA-registered enterprise enjoying preferential tax treatment under a special law. After investigation of its withholding tax returns for the taxable year 1997, the BIR issued a deficiency withholding tax assessment in the amount of P150.000.00. On May 15, 1999, because of financial difficulty, the deficiency tax remained unpaid, as a result of which the assessment became final and executory. The

BIR also found that, in violation of the provisions of the National Internal Revenue Code, Minolta did not file its final corporate income tax return for the taxable year 1998, because it allegedly incurred net loss from its operations. On May 17, 2002, the BIR filed with the Regional Trial Court an action for collection of the deficiency withholding tax for 1997.

A. Will the BIR's action for collection prosper? As counsel of Minolta, what action will you take? Explain your answer. (5%)

**SUGGESTED ANSWER:**

A. Yes, BIR's action for collection will prosper because the assessment is already final and executory, it can already be enforced through judicial action.

As counsel of Minolta, I will introduce evidence that the income payment was reported by the payee and the income tax was paid thereon in 1997 so that my client may only be allowed to pay the civil penalties for non-withholding pursuant to RMO No. 38-83.

[**Note:** *It is not clear whether this is a case of non-withholding/ underwithholding or non-remittance of tax withheld. As such, the tax counsel may be open to other remedies against the assessment.*]

B. May criminal violations of the Tax Code be compromised? If Minolta makes a voluntary offer to compromise the criminal violations for non-filing and non-payment of taxes for the year 1998, may the Commissioner accept the offer? Explain (5%)

**SUGGESTED ANSWER:**

B. All criminal violations of the Tax Code may be compromised except those already filed in court or those involving fraud (Section 204, NIRC). Accordingly, if Minolta makes a voluntary offer to compromise the criminal violations for non-filing and non-payment of taxes for the year 1998, the Commissioner may accept the offer which is allowed by law. However, if it can be established that a tax has not been paid as a consequence of non-filing of the return, the civil liability for taxes may be dealt with independently of the criminal violations. The compromise settlement of the criminal violations will not relieve the taxpayer from its civil liability. But the civil liability for taxes may also be compromised if the financial position of the taxpayer demonstrates a clear inability to pay the tax.

### Custom: Violation of Tax & Custom Duties (2002)

The Collector of Customs of the Port of Cebu issued warrants of seizure and detention against the importation of machineries and equipment by LLD Import and Export Co. (LLD) for alleged nonpayment of tax and customs duties in violation of customs laws. LLD was notified of the seizure, but, before it could be heard, the Collector of Customs issued a notice of sale of the articles. In order to restrain the Collector from carrying out the order to sell, LLD filed with the Court of Tax Appeals a petition for review with application for the issuance of a writ of prohibition. It also filed with the CTA an appeal for refund of overpaid taxes on its other importations of raw materials which has been pending with the Collector of Customs. The Bureau of Customs moved to dismiss the case for lack of jurisdiction of the Court of Tax Appeals.

A. Does the Court of Tax Appeals have jurisdiction over the petition for review and writ of prohibition? Explain (3%)

**SUGGESTED ANSWER:**

A. No, because there is no decision as yet by the Commissioner of Customs which can be appealed to the CTA. Neither the remedy of prohibition would lie because the CTA has not acquired any appellate jurisdiction over the seizure case. The writ of prohibition being merely ancillary to the appellate jurisdiction, the CTA has no jurisdiction over it until it has acquired jurisdiction on the petition for review. Since there is no appealable decision, the CTA has no jurisdiction over the petition for review and writ of prohibition. (***Commissioner of Customs v. Alikpala, 36 SCRA 208 [1970]***).

B. Will an appeal to the CTA for tax refund be possible? Explain (2%)

**SUGGESTED ANSWER:**

B. No, because the Commissioner of Customs has not yet rendered a decision on the claim for refund. The jurisdiction of the Commissioner and the CTA are not concurrent in so far as claims for refund are concerned. The only exception is when the Collector has not acted on the protested payment for a long time, the continued inaction of the Collector or Commissioner should not be allowed to prejudice the taxpayer. (Nestle Phils., Inc. v. Court of Appeals, GR No. 134114, July 6, 2001).

### Customs; Basis; Automatic Review (2002)

Whenever the decision of the Collector of Customs is adverse to the government, it is automatically elevated to the Commissioner for review and, if it is affirmed by him, it is automatically elevated to the Secretary of Finance for review. What is the basis of the automatic review procedure in the Bureau of Customs? Explain your answer. (5%)

**SUGGESTED ANSWER:**

Automatic review is intended to protect the interest of the Government in the collection of taxes and customs duties in seizure and protest cases. Without such automatic review, neither the Commissioner of Customs nor the Secretary of Finance would know about the decision laid down by the Collector favoring the taxpayer. The power to decide seizure and protest cases may be abused if no checks are instituted. Automatic review is necessary because nobody is expected to appeal the decision of the Collector which is favorable to the taxpayer and adverse to the Government. This is the reason why whenever the decision of the Collector is adverse to the Government, the said decision is automatically elevated to the Commissioner for review; and if such decision is affirmed by the Commissioner, the same shall be automatically elevated to and be finally reviewed by the Secretary of Finance (***Yaokasin v. Commissioner of Customs, 180 SCRA 591 [1989]***).

### Delinquent Tax Return (1998)

When is a revenue tax considered delinquent? [3%)

**SUGGESTED ANSWER:**

A revenue tax is considered delinquent when it is unpaid after the lapse of the last day prescribed by law for its payment. Likewise, it could also be considered as delinquent where an assessment for deficiency tax has become final and the taxpayer has not paid it within the period given in the notice of assessment.

### Jurisdiction: Customs vs. CTA (2000)

a) On the basis of a warrant of seizure and detention issued by the Collector of Customs for the purpose of enforcing the Tariff and Customs Laws, assorted brands of cigarettes said to have been illegally imported into the Philippines were seized from a store where they were openly offered for sale. Dissatisfied with the decision rendered after hearing by the Collector of Customs on the confiscation of the articles, the importer filed a petition for review with the Court of Tax Appeals. The Collector moved to dismiss the petition for lack of Jurisdiction. Rule on the motion. (2%)

**SUGGESTED ANSWER:**

Motion granted. The Court of Tax Appeals has jurisdiction only over decisions of the Commissioner of Customs in cases involving seizures, detention or release of property affected. (Sec. 7, R.A. No. 1125). There is no decision yet of the Commissioner which is subject to review by the Court of Tax Appeals.

**ALTERNATIVE ANSWER:**

Motion granted. The Court of Tax Appeals has no jurisdiction because there is no decision rendered by the Commissioner of Customs on the seizure and forfeiture case. The taxpayer should have appealed the decision rendered by the Collector within fifteen (15) days from receipt of the decision to the Commissioner of Customs. The Commissioner's adverse decision would then be the subject of an appeal to the Court of Tax Appeals.

b) Under the same facts, could the importer file an action in the Regional Trial Court for replevin on the ground that the articles are being wrongfully detained by the Collector of Customs since the importation was not illegal and therefore exempt from seizure? Explain. (3%)

**SUGGESTED ANSWER:**

No. The legislators intended to divest the Regional Trial Courts of the jurisdiction to replevin a property which is a subject of seizure and forfeiture proceedings for violation of the Tariff and Customs Code otherwise, actions for forfeiture of property for violation of the Customs laws could easily be undermined by the simple device of replevin. (***De la Fuente v. De Veyra, et. al, 120 SCRA 455***)

There should be no unnecessary hindrance on the government's drive to prevent smuggling and other frauds upon the Customs. Furthermore, the Regional Trial Court do not have Jurisdiction in order to render effective and efficient the collection of Import and export duties due the State, which enables the government to carry out the functions It has been Instituted to perform. (***Jao, et al, Court of Appeals, et al, and companion case, 249 SCRA 35, 43***)

### LGU: Collection of Taxes, Fees & Charges (1997)

Give the remedies available to local government units to enforce the collection of taxes, fees, and charges?

**SUGGESTED ANSWER:**

The remedies available to the local government units to enforce collection of taxes, fees, and charges are:

1) ADMINISTRATIVE REMEDIES of distraint of personal property of whatever kind whether tangible or intangible, and levy of real property and interest therein; and
2) JUDICIAL REMEDY by institution of an ordinary civil action for collection with the regular courts of proper jurisdiction.

### Tax Amnesty vs. Tax Exemption (2001)

Distinguish a tax amnesty from a tax exemption. (3%)

**SUGGESTED ANSWER:**

Tax amnesty is an immunity from all criminal, civil and administrative liabilities arising from nonpayment of taxes. It is a general pardon given to all taxpayers. It applies only to past tax periods, hence of retroactive application. (***People v. Costonedo, G.R. No. L-46881, 1988***).

Tax exemption is an immunity from the civil liability only. It is an immunity or privilege, a freedom from a charge or burden to which others are subjected. (***Florer v. Sheridan, 137 Ind. 28, 36 ME 365***). It is generally prospective in application.

### Taxpayer: Administrative & Judicial Remedies (2000)

Describe separately the procedures on the legal remedies under the Tax Code available to an aggrieved taxpayer both at the administrative and judicial levels. (5%)

**SUGGESTED ANSWER:**

The legal remedies of an aggrieved taxpayer under the Tax Code, both at the administrative and judicial levels, may be classified into those for ***assessment***, ***collection*** and ***refund***.

The procedures for the **ADMINISTRATIVE REMEDIES** for ***ASSESSMENT*** are as follows:

a. After receipt of the Pre-Assessment Notice, he must within fifteen (15) days from receipt explain why no additional taxes should be assessed against him.

b. If the Commissioner of Internal Revenue issues an assessment notice, the taxpayer must administratively protest or dispute the assessment by filing a motion for reconsideration or reinvestigation within thirty (30) days from receipt of the notice of assessment. (4th par.. Sec. 228, NIRC of 1997)

c. Within sixty (60) days from filing of the protest, the taxpayer shall submit all relevant supporting documents.

The **JUDICIAL REMEDIES** of an aggrieved taxpayer relative to an ***ASSESSMENT NOTICE*** are as follows:

a. Where the Commissioner of Internal Revenue has not acted on the taxpayer's protest within a period of one hundred eighty (180) days from submission of all relevant documents, then the taxpayer has a period of thirty (30) days from the lapse of said 180 days within which to interpose a petition for review with the Court of Tax Appeals.

b. Should the Commissioner deny the taxpayer's protest, then he has a period of thirty (30) days from receipt of said denial within which to interpose a petition for review with the Court of Tax Appeals.

In both cases the taxpayer must apply with the Court of Tax Appeals for the Issuance of an Injunctive writ to enjoin the Bureau of Internal Revenue from collecting the disputed tax during the pendency of the proceedings.

**NOTE:** A 2004 Amendment - The decision of the division of CTA is in turn appeallable within fifteen (15) days to the CTA en banc. The decision of the CTA en banc is directly appeallable to the Supreme Court on question of law on certiorari.

The employment by the Bureau of Internal Revenue of any of the **Administrative Remedies** for the ***collection of the tax*** like distraint, levy, etc. may be administratively appealed by the taxpayer to the Commissioner whose decision is appealable to the Court of Tax Appeals under other matter arising under the provisions of the National Internal Revenue Code.

The judicial appeals starts with the Court of Tax Appeals, and continues in the same manner as shown above.

Should the Bureau of Internal Revenue decide to utilize its Judicial tax remedies for collecting the taxes by means of an ordinary suit filed with the regular courts for the collection of a sum of money, the taxpayer could oppose the same going up the ladder of judicial processes from the Municipal Trial Court (as the case may be) to the Regional Trial Court, to the Court of Appeals, thence to the Supreme Court.

The remedies of an aggrieved taxpayer on a claim for refund is to appeal the adverse decision of the Commissioner to the CTA in the same manner outlined above.

### Taxpayer: Assessment: Protest: Claims for refund (2000)

On June 16, 1997, the Bureau of Internal Revenue (BIR) issued against the Estate of Jose de la Cruz a notice of deficiency estate tax assessment, inclusive of surcharge, interest and compromise penalty. The Executor of the Estate of Jose de la Cruz (Executor) filed a timely protest against the assessment and requested for waiver of the surcharge, interest and penalty. The protest was denied by the Commissioner of Internal Revenue (Commissioner) with finality on September 13, 1997. Consequently, the Executor was made to pay the deficiency assessment on October 10, 1997. The following day, the Executor filed a Petition with the Court of Tax Appeals (CTA) praying for the refund of the surcharge, interest and compromise penalty. The CTA took cognizance of the case and ordered the Commissioner to make a refund. The Commissioner filed a Petition for Review with the Court of Appeals assailing the jurisdiction of the CTA and the Order to make refund to the Estate on the ground that no claim for refund was filed with the BIR.

**A.** Is the stand of the Commissioner correct? Reason. (2%)

**SUGGESTED ANSWER:**

Yes. There was no claim for refund or credit that has been duly filed with the Commissioner of Internal Revenue which is required before a suit or proceeding can be filed in any court (Sec. 229. NIRC of 1997). The denial of the claim by the Commissioner is the one which will vest the Court of Tax Appeals jurisdiction over the refund case should the taxpayer decide to appeal on time.

**B.** Why is the filing of an administrative claim with the BIR necessary? (3%)

**SUGGESTED ANSWER:**

The filing of an administrative claim for refund with the BIR is necessary in order:

1) To afford the Commissioner an opportunity to consider the claim and to have a chance to correct the errors of subordinate officers (***Gonzales v. CTA, et al, 14 SCRA 79***); and
2) To notify the Government that such taxes have been questioned and the notice should be borne in mind in estimating the revenue available for expenditures. (***Bermejo v. Collector, G.R. No. L-3028. July 29, 1950***)

### Taxpayer: Assessment; Injunction (2004)

RR disputed a deficiency tax assessment and upon receipt of an adverse decision by the Commissioner of Internal Revenue, filed an appeal with the Court of Tax Appeals. While the appeal is pending, the BIR served a warrant of levy on the real properties of RR to enforce the collection of the disputed tax. Granting *arguendo* that the BIR can legally levy on the properties, what could RR do to stop the process? Explain briefly. (5%)

**SUGGESTED ANSWER:**

RR should file a motion for injunction with the Court of Tax Appeals to stop the administrative collection process. An appeal to the CTA shall not suspend the enforcement of the tax liability, unless a motion to that effect shall have been presented in court and granted by it on the basis that such collection will jeopardize the interest of the taxpayer or the Government (***Pirovano v. CIR, 14 SCRA 832 [1965]***).

The CTA is empowered to suspend the collection of internal revenue taxes and customs duties in cases pending appeal only when: (1) in the opinion of the court the collection by the BIR will jeopardize the interest of the Government and/or the taxpayer; and (2) the taxpayer is willing to deposit the amount being collected or to file a surety bond for not more than double the amount of the tax to be fixed by the court *(Section 11, JR.A. No. 1125).*

### Taxpayer: BIR Audit or Investigation (1999)

A Co., a Philippine corporation, is a big manufacturer of consumer goods and has several suppliers of raw materials. The BIR suspects that some of the suppliers are not properly reporting their income on their sales to A Co. The CIR therefore:

1) Issued an access letter to A Co. to furnish the BIR information on sales and payments to its suppliers.
2) Issued an access letter to a bank (CX Bank) to furnish the BIR on deposits of some suppliers of A Co. on the alleged ground that the suppliers are committing tax evasion.

A Co., X Bank and the suppliers have not been issued by the BIR letter of authority to examine. A Co. and X Bank believe that the BIR is on a "fishing expedition" and come to you for counsel. What is your advice? (10%)

**SUGGESTED ANSWER:**

I will advise A Co. and B Co. that the BIR is justified only in getting information from the former but not from the latter. The BIR is authorized to obtain information from other persons other than those whose internal revenue tax liability is subject to audit or investigation. However, this power shall not be construed as granting the Commissioner the authority to inquire into bank deposits. *(Section 5. NIRC).*

### Taxpayer: City Board of Assessment Decision; Where to appeal (1999)

A Co., a Philippine corporation, is the owner of machinery, equipment and fixtures located at its plant in Muntinlupa City. The City Assessor characterized all these properties as real properties subject to the real property tax. A Co. appealed the matter to the Muntinlupa Board of Assessment Appeals. The Board ruled in favor of the City. In accordance with RA 1125 (An Act creating the Court of Tax Appeals). A Co. brought a petition for review before the CTA to appeal the decision of the City Board of Assessment Appeals. Is the Petition for Review proper? Explain. (5%)

**SUGGESTED ANSWER:**

No. The CTA's devoid of jurisdiction to entertain appeals from the decision of the City Board of Assessment Appeals. Said decision is instead appealable to the Central Board of Assessment Appeals, which under the Local Government Code, has appellate jurisdiction over decisions of Local Board of Assessment Appeals. (***Caltex Phils, foe. v. Central Board of Assessment Appeals, L-50466, May 31, 1982***).

### Taxpayer: Claim for Refund; Procedure (2002)

A. What must a taxpayer do in order to claim a refund of, or tax credit for, taxes and penalties which he alleges to have been erroneously, illegally or excessively assessed or collected? (3%)

**SUGGESTED ANSWER:**

The taxpayer must comply with the following procedures in claiming a refund of, or tax credit for, taxes and penalties which he alleges to have been erroneously, illegally or excessively assessed or collected:

2. He should file a written claim for refund with the Commissioner within two years after the date of payment of the tax or penalty (Sec. 204, NIRC);
3. The claim filed must state a categorical demand for reimbursement ***(Bermejo v. Collector, 87 Phil. 96 [1950]).***
4. The suit or proceeding for recovery must be commenced in court within two years from date of payment of the tax or penalty regardless of any supervening event that will arise after payment (Sec. 229, NIRC).

*[Note: If the answer given is only number 1, it is suggested that the same shall be given full credit considering that this is the only requirement for the Commissioner to acquire jurisdiction over the claim.]*

B. Can the Commissioner grant a refund or tax credit even without a written claim for it? (2%)

**SUGGESTED ANSWER:**

B. Yes. When the taxpayer files a return which on its face shows an overpayment of the tax and the option to refund/ claim a tax credit was chosen by the taxpayer, the Commissioner shall grant the refund or tax credit without the need for a written claim. This is so, because a return filed showing an overpayment shall be considered as a written claim for credit or refund. (*Sees. 76 and 204, NIRC*). Moreover, the law provides that the Commissioner may, even without a written claim therefor, refund or credit any tax where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid. (*Sec. 229, NIRC*).

### Taxpayer: Deficiency Income Tax (1995)

Businessman Stephen Yang filed an income tax return for 1993 showing business net income of P350,000.00 on which he paid an income tax of P61,000.00. After filing the return he realized that he forgot to include an item of business income in 1993 for P50.000.00. Being an honest taxpayer, he included this income in his return for 1994 and paid the corresponding income tax thereon. In the examination of his 1993 return the BIR examiner found that Stephen Yang failed to report this item of P50.000.00 and assessed him a deficiency income tax on this item, plus a 50% fraud surcharge.

1) Is the examiner correct? Explain.
2) If you were the lawyer of Stephen Yang, what would you have advised your client before he included in his 1994 return the amount of P50.000.00 as 1993 income to avoid the fraud surcharge? Explain.
3) Considering that Stephen Yang had already been assessed a deficiency income tax for 1993 for his failure to report the P50.000.00 income, what would you advise him to do to avoid the penalties for tax delinquency? Explain.
4) What would you advise Stephen Yang to do with regard to the income tax he paid for the P50.000.00 in his 1994 return? In case your remedy fails, what is your other recourse? Explain.

**SUGGESTED ANSWERS:**

1) The examiner is correct in assessing a deficiency income tax for taxable year 1993 but not in imposing the 50% fraud surcharge. The amount of all items of gross income must be included in gross income during the year in which received or realized (Sec. 38, NIRC). The 50%

fraud surcharge attaches only if a false or fraudulent return is willfully made by Mr. Yang (Sec.248, NIRC). The fact that Mr. Yang included the income in his 1994 return belies any claim of willfulness but is rather indicative of an honest mistake which was sought to be rectified by a subsequent act, that is the filing of the 1994 return.

2) Mr. Yang should have amended his 1993 Income tax return to allow for the inclusion of the P50.000 income during the taxable period it was realized.

3) Mr. Yang should file a protest questioning the 50% surcharge and ask for the abatement thereof.

**ALTERNATIVE ANSWER:**

Mr. Yang should pay the deficiency income tax on or before the day prescribed for its payment per notice of demand. After payment and within two years thereafter, he should file a claim for refund of taxes erroneously paid to recover the excessive surcharge imposed.

4) Mr. Yang should file a written claim for refund with the Commissioner of Internal Revenue of the taxes paid on the P50.000 income included in 1994 within two years from payment pursuant to Section 204(3) of the Tax Code. Should this remedy fail in the administrative level, a judicial claim for refund can be instituted before the expiration of the two year period.

### Taxpayer: Exhaustion of Administrative Remedies (1997)

(a) A taxpayer received, on 15 January 1996 an assessment for an internal revenue tax deficiency. On 10 February 1996, the taxpayer forthwith filed a petition for review with the Court of Tax Appeals. Could the Tax Court entertain the petition?

(b) Under the above factual setting, the taxpayer, instead of questioning the assessment he received on 15 January 1996 paid, on 01 March 1996 the "deficiency tax" assessed. The taxpayer requested a refund from the Commissioner by submitting a written claim on 01 March 1997. It was denied. The taxpayer, on 15 March 1997, filed a petition for review with the Court of Appeals. Could the petition still be entertained?

**SUGGESTED ANSWER:**

(a) No. Before taxpayer can avail of Judicial remedy he must first exhaust administrative remedies by filing a protest within 30 days from receipt of the assessment. It is the Commissioner's decision on the protest that give the Tax Court jurisdiction over the case provided that the appeal is filed within 30 days from receipt of the Commissioner's decision. An assessment by the BIR is not the Commissioner's decision from which a petition for review may be filed with the Court of Tax Appeals. Rather, it is the action taken by the Commissioner in response to the taxpayer's protest on the assessment that would constitute the appealable decision (Section 7, RA 1125).

(b) No, the petition for review can not be entertained by the Court of Appeals, since decisions of the Commissioner on cases involving claim for tax refunds are within the exclusive and primary jurisdiction of the Court of Tax Appeals (Section 7.RA1125).

### Taxpayer: Failure to Withheld & Remit Tax (2000)

A domestic corporation failed to withhold and remit the tax on income received from Philippine sources by a non-resident foreign corporation. In addition to the civil penalties provided for under the Tax Code, a compromise penalty was imposed for violation of the withholding tax provisions. May the Commissioner of Internal Revenue legally enforce the collection of compromise penalty? (5%)

**SUGGESTED ANSWER:**

No. There is no showing that the compromise penalty was imposed by the Commissioner of Internal Revenue with the agreement and conformity of the taxpayer. (***Wonder Mechanical Engineering Corporation u. Court of Tax Appeals, et. al., 64 SCRA 555***).

### Taxpayer: NIRC vs. TCC Remedies (1996)

Compare the taxpayer's remedies under the National Internal Revenue Code and the Tariff and Customs Code.

**SUGGESTED ANSWER:**

The taxpayer's remedies under the **NATIONAL INTERNAL REVENUE CODE** may be categorized into remedies before payment and remedies after payment. The remedy ***BEFORE PAYMENT*** consists of

(a) ***Administrative Remedy*** which is the filing of protest within 30 days from receipt of assessment, and

(b) ***Judicial Remedy*** which is the appeal of the adverse decision of the Commissioner on the protest with the Court of Tax Appeals, and finally with the Supreme Court.

The remedy ***AFTER PAYMENT*** is availed of

(c) by paying the assessed tax within 30 days from receipt of assessment and

(d) the filing of a claim for refund or tax credit of these taxes on grounds that they are erroneously paid within two years from date of payment.

(e) *If there is a denial of the claim*, appeal to the CTA shall be made within 30 days from denial but within two years from date of payment.

- If the Commissioner fails to act on the claim for refund or tax credit and the two-year period is about to expire, the taxpayer should consider the continuous inaction of the Commissioner as a denial and elevate the case to the CTA before the expiration of the two-year period.

Under the **Tariff and Customs Code**, taxpayer's remedies arise only after payment of duties.

4) The administrative remedies consist of filing a claim for refund which may take the form of abatement or drawback.

5) The taxpayer can also file a protest within 15 days from payment if he disagrees with the ruling or decision of the Collector of Customs regarding the legality or correctness of the assessment of customs duties.

6) If the decision of the Collector is adverse to the taxpayer, he can notify the Collector within 15 days from receipt of said decision of his desire to have his case reviewed by the Commissioner.
   - The decision of the Collector on the taxpayer's protest, if adverse to the Government, is automatically elevated to the Commissioner for review; and if such decision is affirmed by the Commissioner, the same shall be automatically elevated to and finally reviewed by the Secretary of Finance.

   - Resort to judicial relief can be had by the taxpayer by appealing the decision of the Commissioner or of the Secretary of Finance (for cases subject to automatic review) within 30 days from the promulgation of the adverse decision to the CTA.

### Taxpayer: Overwitholding Claim for Refund (1999)

A Co. is the wholly owned subsidiary of B Co., a non-resident German company. A Co. has a trademark licensing agreement with B Co. On Feb. 10, 1995, A Co. remitted to B Co. royalties of P 10,000,000, which A Co. subjected to a withholding tax of 25% or P2,500,000. Upon advice of counsel, A Co. realized that the proper withholding tax rate is 10%. On March 20, 1996, A Co. filed a claim for refund of P2.500.000 with the BIR. The BIR denied the claim on Nov. 15, 1996. On Nov. 28, 1996, A Co. filed a petition for review with the CTA. The BIR attacked the capacity of A Co., as agent, to bring the refund case. Decide the issue. (5%)

**SUGGESTED ANSWER:**

A Co., the withholding agent of the non-resident foreign corporation is entitled to claim the refund of excess withholding tax paid on the income of said corporation in the Philippines. Being a withholding agent, it is the one held liable for any violation of the withholding tax law should such a violation occur. In the same vein, it should be allowed to claim a refund in case of overwitholding. (***CIR v. Wander Phils. Inc., GR No. 68378, April 15, 1988, 160 SCRA 573; CIR v. Procter & Gamble PMC, 2O4 SCRA 377***).

### Taxpayer: Prescriptive Period: Suspended (2000)

Mr. Reyes, a Filipino citizen engaged in the real estate business, filed his 1994 income tax return on March 20, 1995. On December 15, 1995, he left the Philippines as an immigrant to join his family in Canada. After the investigation of said return/the BIR issued a notice of deficiency income tax assessment on April 15, 1998. Mr. Reyes returned to the Philippines as a balikbayan on December 8, 1998. Finding his name to be in the list of delinquent taxpayers, he filed a protest against the assessment on the ground that he did not receive the notice of assessment and that the assessment had prescribed. Will the protest prosper? Explain. (5%)

**SUGGESTED ANSWER:**

No. Prescription has not set in because the period of limitations for the Bureau of Internal Revenue to issue an assessment was ***SUSPENDED*** during the time that Mr. Reyes was out of the Philippines or from the period December 15, 1995 up to December 8, 1998.
*(Sec. 223 in relation to Sec. 203, both of the NIRC of 1997)*

### Taxpayer: Prescriptive Period; Claim for Refund (1997)

A corporation files its income tax return on a calendar year basis. For the first quarter of 1993, it paid on 30 May 1993 its quarterly income tax in the amount of P3.0 million. On 20 August 1993, it paid the second quarterly income tax of P0.5 million. The third quarter resulted in a net loss, and no tax was paid. For the fourth and final return for 1993, the company reported a net loss for the year, and the taxpayer indicated in the income tax return that it opted to claim a refund of the quarterly income tax payments. On 10 January 1994, the corporation filed with the Bureau of Internal Revenue a written claim for the refund of P3.5 million.

BIR failed to act on the claim for refund; hence, on 02 March 1996, the corporation filed a petition for review with the Court of Tax Appeals on its claim for refund of the overpayment of its 1993 quarterly income tax. BIR, in its answer to the petition, alleged that the claim for refund was filed beyond the reglementary period. Did the claim for refund prescribe?

**SUGGESTED ANSWER:**

The claim for refund has prescribed. The counting of the ***two-year prescriptive period for filing a claim for refund*** is counted not from the date when the quarterly income taxes were paid but on the date when the final adjustment return or annual income tax return was filed (***CIR v. TMX Sales Inc., G.R. No. 83736, January 15, 1992; CIR v. Phi/Am Life Insurance Co., Inc., G.R. No. 105208, May 29, 1995***). It is obvious that the annual income tax return was filed before January 10, 1994 because the written claim for refund was filed with the BIR on January 10, 1994. Since the two-year prescriptive period is not only a limitation of action in the administrative stage but also a limitation of action for bringing the case to the judicial stage, the petition for review filed with the CTA on March 02, 1996 is beyond the reglementary period.

### Taxpayer: Prescriptive Period; Claims for Refund (1994)

XCEL Corporation filed its quarterly income tax return for the first quarter of 1985 and paid an income tax of P500.000.00 on May 15, 1985. In the subsequent quarters, XCEL suffered losses so that on April 15, 1986 it declared a net loss of P1,000,000.00 in its annual income tax return. After failing to get a refund, XCEL filed on March 1, 1988 a case with the Court of Tax Appeals to recover the P500.000.00 in taxes paid on May 15, 1985.
Is the action to recover the taxes filed timely?

**SUGGESTED ANSWER:**

The action for refund was filed in the Court of Tax Appeals on time. In the case of ***Commissioner v. TMX Sales, Inc., 205 SCRA 184***, which is similar to this case, the Supreme Court ruled that in the case of overpaid quarterly corporate income tax, the two-year period for filing claims for refund in the BIR as well as in the institution of an action for refund in the CTA, the two-year prescriptive period for tax refunds (Sec. 230, Tax Code) is counted from the filing of the final, adjustment return under Sec. 67 of the Tax Code, and not from the filing of the

quarterly return and payment of the quarterly tax. The CTA action on March 1, 1988 was clearly within the reglementary two-year period from the filing of the final adjustment return of the corporation on April 15, 1986.

### Taxpayer: Prescriptive Period; Claims for Refund (2004)

On March 12, 2001, REN paid his taxes. Ten months later, he realized that he had overpaid and so he immediately filed a claim for refund with the Commissioner of Internal Revenue.

On February 27, 2003, he received the decision of the Commissioner denying REN's claim for refund. On March 24, 2003, REN filed an appeal with the Court of Tax Appeals. Was his appeal filed on time or not? Reason. (5%)

**SUGGESTED ANSWER:**

The appeal was not filed on time. The two-year period of limitation for filing a claim for refund is not only a limitation for pursuing the claim at the administrative level but also a limitation for appealing the case to the Court of Tax Appeals. The law provides that "no suit or proceeding shall be filed after the expiration of two years from the date of the payment of the tax or penalty regardless of any supervening cause that may arise after payment (Section 229, JVZRCJ. Since the appeal was only made on March 24, 2003, more than two years had already elapsed from the time the taxes were paid on March 12, 2003. Accordingly, REN had lost his judicial remedy because of prescription.

### Taxpayer: Protest against Assessment (1998)

CFB Corporation, a domestic corporation engaged in food processing and other allied activities, received a letter from the BIR assessing it for delinquency income taxes. CFB filed a letter of protest. One month after, a warrant of distraint and levy was served on CFB Corporation. If you were the lawyer engaged by CFB Corporation to contest the assessment made by the BIR, what steps will you take to protect your client? (5%)

**SUGGESTED ANSWER:**

I shall immediately file a motion for reconsideration of the issuance of the warrant of distraint and levy and seek from the BIR Commissioner a denial of the protest "in clear and unequivocal language." This is so because the issuance of a warrant of distraint and levy is not considered as a denial by the BIR of the protest filed by CFB Corporation (***CIR v. Union Shipping Corp., 185 SCRA 547***).

Within thirty (30) days from receipt of such denial "in clear and unequivocal language," I shall then file a petition for review with the Court of Tax Appeals.

**ALTERNATIVE ANSWER:**

Within thirty (30) days from receipt of the warrant of distraint and levy, I shall file a petition for review with the Court of Tax Appeals with an application for issuance of a writ of preliminary injunction to enjoin the Bureau of Internal Revenue from enforcing the warrant.

This is the action I shall take because I shall consider the issuance of the warrant as a final decision of the Commissioner of Internal Revenue which could be the subject of appeal to the Court of Tax Appeals (***Yobes u. Flojo, 15 SCRA 278***). The CTA may, however, remand the case to the BIR and require the Commissioner to specifically rule on the protest. The decision of the Commissioner, if adverse to my client, would then constitute an appealable decision.

### Taxpayer: Protest against Assessment (1999)

A Co., a Philippine corporation, received an income tax deficiency assessment from the BIR on May 5, 1995. On May 31, 1995, A Co. filed its protest with the BIR. On July 30, 1995, A Co. submitted to the BIR all relevant supporting documents. The CIR did not formally rule on the protest but on January 25, 1996, A Co. was served a summons and a copy of the complaint for collection of the tax deficiency filed by the BIR with the Regional Trial Court (RTC). On February 20, 1996, A Co. brought a Petition for Review before the CTA. The BIR contended that the Petition is premature since there was no formal denial of the protest of A Co. and should therefore be dismissed.

1. Has the CTA jurisdiction over the case?

**SUGGESTED ANSWER;**

Yes, the CTA has jurisdiction over the case because this qualifies as an appeal from the Commissioner's decision on disputed assessment. When the Commissioner decided to collect the tax assessed without first deciding on the taxpayer's protest, the effect of the Commissioner's action of filing a judicial action for collection is a decision of denial of the protest, in which event the taxpayer may file an appeal with the CTA. (***Republic v. Lim Tian Teng & Sons, Inc., 16 SCRA 584; Dayrit v. Cruz, L-39910, Sept. 26, 1988***).

2. Has the RTC jurisdiction over the collection case filed by the BIR? Explain.

**SUGGESTED ANSWER;**

The RTC has no jurisdiction over the collection case filed by the BIR. The filing of an appeal with the CTA has the effect of divesting the RTC of jurisdiction over the collection case. At the moment the taxpayer appeals the case to the Court of Tax Appeals in view of the Commissioner's filing of the collection case with the RTC which was considered as a decision of denial, it gives a justifiable basis for the taxpayer to move for dismissal in the RTC of the Government's action to collect the tax liability under dispute. (***Yabes v. Flojo, 15 SCRA 278; San Juan v. Vasquez, 3 SCRA 92***). There is no final, executory and demandable assessment which can be enforced by the BIR, once a timely appeal is filed.

### Taxpayer: Protest against Assessment (1999)

A Co., a Philippine corporation, received an income tax deficiency assessment from the BIR on November 25, 1996. On December 10, 1996, A Co. filed its protest with the BIR On May 20, 1997, the BIR issued a warrant of distraint to enforce the assessment. This warrant was served on A Co. on May 25, 1997. In a letter dated June 4, 1997 and received by A Co. 5 days later, the CIR formally denied A Co.'s protest stating that it constitutes his final decision on the matter. On July 6, 1997, A Co. filed a Petition for Review with the CTA. The BIR moved to

dismiss the Petition on the ground that the CTA has no jurisdiction over the case. Decide. (10%)

**SUGGESTED ANSWER:**

The CTA has jurisdiction over the case. The appealable decision is the one which categorically stated that the Commissioner's action on the disputed assessment is final and, therefore, the reckoning of the 30-day period to appeal was on June 9, 1999. The filing of the petition for review with the CTA was timely made. The Supreme Court has ruled that the CIR must categorically state that his action on a disputed assessment is final; otherwise, the period to appeal will not commence to run. That final action cannot be implied from the mere issuance of a warrant "of distraint and levy. (***CIR v. Union Shipping Corporation, 185 SCRA 547***).

### Taxpayer: Protest; Claim of Refund (1996)

Is protest at the time of payment of taxes and duties a requirement to preserve the taxpayers' right to claim a refund? Explain.

**SUGGESTED ANSWER:**

For **TAXES** imposed under the **NIRC,** protest at the time of payment is not required to preserve the taxpayers' right to claim refund. This is clear under *Section 230 of the NIRC* which provides that a suit or proceeding maybe maintained for the recovery of national internal revenue tax or penalty alleged to have been erroneously assessed or collected, whether such tax or penalty has been paid under protest or not.

For **DUTIES** imposed under the **Tariff and Customs Code**, a protest at the time of payment is required to preserve the taxpayers' claim for refund. The procedure under the TCC is to the effect that when a ruling or decision of the Collector of Customs is made whereby liability for duties is determined, the party adversely affected may protest such ruling or decision by presenting to the Collector, at the time when payment is made, or within 15 days thereafter, a written protest setting forth his objections to the ruling or decision in question (Sec. 2308. TCC).

### Taxpayer; Appeal to the Court of Tax Appeals (2005)

A taxpayer received a tax deficiency assessment of P1.2 Million from the BIR demanding payment within 10 days, otherwise, it would collect through summary remedies. The taxpayer requested for a reconsideration stating the grounds therefor. Instead of resolving the request for reconsideration, the BIR sent a Final Notice before Seizure to the taxpayer.

May this action of the Commissioner of Internal Revenue be deemed a denial of the request for reconsideration of the taxpayer to entitle him to appeal to the Court of Tax Appeals? Decide with reasons. (5%)

**SUGGESTED ANSWER:**

Yes, the final notice before seizure was in effect a denial of the taxpayer's request for reconsideration, not only was the notice the only response received, its nature, content and tenor supports the theory that it was the BIR's final act regarding the request for reconsideration. ***(CIR v. Isabela Cultural Corporation, G.R. No. 135210, July 11, 2001)***

### Taxpayer; Claim for Tax Credits (2006)

Congress enacts a law granting grade school and high school students a 10% discount on all school-prescribed textbooks purchased from any bookstore. The law allows bookstores to claim in full the discount as a tax credit.

1. If in a taxable year a bookstore has no tax due on which to apply the tax credits, can the bookstore claim from the BIR a tax refund in lieu of tax credit? Explain. (2.5%)

**SUGGESTED ANSWER:**

No, the bookstore cannot claim from the BIR a tax refund in lieu of tax credit. There is nothing in the law that grants a refund when the bookstore has no tax liability against which the tax credit can be used ***(CIR v. Central Luzon Drug, G.R. No 159647, April 15, 2005)***. A tax credit is in the nature of a tax exemption and in case of doubt, the doubt should be resolved in *strictissimi juris* against the claimant.

2. Can the BIR require the bookstores to deduct the amount of the discount from their gross income? Explain. (2.5%)

**SUGGESTED ANSWER:**

No. Tax credit which reduces the tax liability is different from a tax deduction which merely reduces the tax base. Since the law allowed the bookstores to claim in full the discount as a tax credit, the BIR is not allowed to expand or contract the legislative mandate ***(CIR v. Bicolandia Drug Corp., G.R. No. 148083, July 21, 2006; CIR v. Central Luzon Drug Corp., G.R. No. 159647, April 15, 2005).***

3. If a bookstore closes its business due to losses without being able to recoup the discount, can it claim reimbursement of the discount from the government on the ground that without such reimbursement, the law constitutes taking of private property for public use without just compensation? Explain. (5%)

**SUGGESTED ANSWER:**

A bookstore, closing its business due to losses, cannot claim reimbursement of the discount from the government. If the business continues to operate at a loss and no other taxes are due, thus compelling it to close shop, the credit can never be applied and will be lost altogether ***(CIR v. Central Luzon Drug, G.R. No. 159647, April 15, 2005).*** The grant of the discount to the taxpayer is a mere privilege and can be revoked anytime.

### Taxpayer; Compromise after Criminal Action (1998)

An information was filed in court for willful non-payment of income tax the assessment of which has become final. The accused, through counsel, presented a motion that he be allowed to compromise his tax liability subject of the information. The prosecutor indicated his conformity to the motion. Is this procedure correct? [5%]

**SUGGESTED ANSWER:**

No. Criminal violations, if already filed in court, may not be compromised *(Sec. 204[B], NIRC).* Furthermore, the payment of the tax due after apprehension shall not constitute a valid defense in any prosecution for violation of any provisions of the Tax Code *(Sec. 247(a), NIRC).* Finally, there is no showing that the prosecutor in the problem is a legal officer of the Bureau of Internal

Revenue to whom the conduct of criminal actions are lodged by the Tax Code.

**ALTERNATIVE ANSWER:**

No. If the compromise referred to is the civil aspect, the procedure followed is not correct. Compromise for the payment of any internal revenue tax shall be made only by the Commissioner of Internal Revenue or in a proper case the Evaluation Board of the BIR (Sec. 204, NIRC). Applying the law to the case at bar, compromise settlement can only be effected by leave of Court.

### Taxpayer; Protest against Assessment; Donor's Tax (1995)

Mr. Rodrigo, an 80-year old retired businessman, fell in love with 20-year old Tetchie Sonora, a night club hospitality girl. Although she refused to marry him she agreed to be his "live-in" partner. In gratitude, Mr. Rodrigo transferred to her a condominium unit, where they both live, under a deed of sale for P10 Million. Mr. Rodrigo paid the capital gains tax of 5% of P10 Million.

The Commissioner of Internal Revenue found that the property was transferred to Tetchie Sonora by Mr. Rodrigo because of the companionship she was providing him. Accordingly, the Commissioner made a determination that Sonora had compensation income of P10 Million in the year the condominium unit was transferred to her and issued a deficiency income tax assessment.

Tetchie Sonora protests the assessment and claims that the transfer of the condominium unit was a gift and therefore excluded from income. How will you rule on the protest of Tetchie Sonora? Explain.

**SUGGESTED ANSWER:**

I will grant the protest and cancel the assessment. The transfer of the property by Mr. Rodrigo to Ms. Sonora was gratuitous. The deed of sale indicating a P10 million consideration was simulated because Mr. Rodrigo did not receive anything from the sale. The problem categorically states that the transfer was made in gratitude to Ms. Sonora's companionship. The transfer being gratuitous is subject to donor's tax. Mr. Rodrigo should be assessed deficiency donor's tax and a 50% surcharge imposed for fraudulently simulating a contract of sale to evade donor's tax. *(Sec. 91(b), NIRC).*

### Taxpayer; Withholding Agent; Claim of Tax Refund (2005)

Does a withholding agent have the right to file an application for tax refund? Explain.

**SUGGESTED ANSWER:**

Yes. A taxpayer is "any person subject to tax." Since, the withholding tax agent who is "required to deduct and withheld any tax" is made "personally liable for such tax" should the amount of the tax withheld be finally found to be less than that required to be withheld by law, then he is a taxpayer. Thus, he has sufficient legal interest to file an application for refund, of the amount he believes was illegally collected from him. ***(Commissioner of Internal Revenue v. Procter & Gamble, G.R. No. 66838, December 2, 1991)***

# LOCAL & REAL PROPERTY TAXES

### Local Taxation: Actual Use of Property (2002)

The real property of Mr. and Mrs Angeles, situated in a commercial area in front of the public market, was declared in their Tax Declaration as residential because it had been used by them as their family residence from the time of its construction in 1990. However, since January 1997, when the spouses left for the United States to stay there permanently with their children, the property has been rented to a single proprietor engaged in the sale of appliances and agri-products. The Provincial Assessor reclassified the property as commercial for tax purposes starting January 1998. Mr. and Mrs. Angeles appealed to the Local Board of Assessment Appeals, contending that the Tax Declaration previously classifying their property as residential is binding. How should the appeal be decided? (5%)

**SUGGESTED ANSWER:**

The appeal should be decided against Mr. and Mrs. Angeles. The law focuses on the actual use of the property for classification, valuation and assessment purposes regardless of ownership. Section 217 of the Local Government Code provides that "real property shall be classified, valued, and assessed on the basis of its actual use regardless of where located, whoever owns it, and whoever uses it".

### Local Taxation: Coverage (2002)

Aside from the basic real estate tax, give three (3) other taxes which may be imposed by provincial and city governments as well as by municipalities in the Metro Manila area. (3%)

**SUGGESTED ANSWER:**

The following real property taxes aside from the basic real property tax may be imposed by provincial and city governments as well as by municipalities in the Metro Manila area:

1. Additional levy on real property for the Special Education Fund (Sec. 235, LGC);
2. Additional Ad-valorem tax on Idle lands (Sec. 23§, LGC); and
3. Special levy (Sec. 240).

[**Note:** The question is susceptible to dual interpretation because it is asking for three other taxes and not three other real property taxes. Accordingly, an alternative answer should be considered and given full credit]

A. The following taxes, aside from basic real estate tax, may be imposed by:

1. Provincial Government
   a. Printer's or publisher's tax
   b. Franchise Tax
   c. Professional tax
2. City Government - may levy taxes which the province or municipality are authorized to levy (Sec. 151, LGC)
   a. Printer's or publisher's tax
   b. Franchise tax
   c. Professional tax

3. Municipalities in the Metro Manila Area - may levy taxes at rates which shall not exceed by 50% the maximum rates prescribed in the Local Government Code.

a. Annual fixed tax on manufacturers, assemblers, repackers, processors, brewers, distillers, rectifiers and compounders of liquors, distilled spirits, and wines or manufacture of any article of commerce of whatever kind or nature;
b. Annual fixed tax on wholesalers, distributors, or dealers in any article of commerce of whatever kind or nature;
c. Percentage tax on retailers

[Note: Other taxes may comprise the enumeration because many other taxes are authorized to be imposed by LGUs.]

### Local Taxation: Exemption; Real Property Taxes (2002)

Under the Local Government Code, what properties are exempt from real property taxes? (5%)

**SUGGESTED ANSWER:**

The following properties are exempt from real property taxes: (Sec. 234, LGC).

1. Real property owned by the Republic of the Philippines or any of its political subdivisions except when the beneficial use thereof has been granted, for consideration or otherwise, to a taxable person;

2. All lands, buildings and improvements actually, directly, and exclusively used for religious, charitable or educational purposes by charitable institutions, churches, parsonages or convents appurtenant thereto, mosques, nonprofit or religious cemeteries;

3. All machineries and equipment that are actually, directly and exclusively used by local water districts and government-owned or controlled corporations engaged in the supply and distribution of water and/or generation and transmission of electric power;

4. All real property owned by duly registered cooperatives as provided for under R.A. No. 6938; and

5. Machinery and equipment used for pollution control and environmental protection.

### Local Taxation: Imposition of Ad Valorem Tax (2000)

May local governments impose an annual realty tax in addition to the basic real property tax on idle or vacant lots located in residential subdivisions within their respective territorial jurisdictions? (3%)

**SUGGESTED ANSWER:**

Not all local government units may do so. Only provinces, cities, and municipalities within the Metro Manila area *(Sec. 232, Local Government Code)* may impose an ***ad valorem tax*** not exceeding five percent (5%) of the assessed value *(Sec. 236, Ibid.)* of idle or vacant residential lots in a subdivision, duly approved by proper authorities regardless of area. *(Sec.237, Ibid.)*

### Local Taxation: Legality/ Constitutionality; Tax Ordinance (2003)

X, a taxpayer who believes that an ordinance passed by the City Council of Pasay is unconstitutional for being discriminatory against him, want to know from you, his tax lawyer, whether or not he can file an appeal. In the affirmative, he asks you where such appeal should be made: the Secretary of Finance, or the Secretary of Justice, or the Court of Tax Appeals, or the regular courts. What would your advice be to your client, X? (8%)

**SUGGESTED ANSWER:**

The appeal should be made with the Secretary of Justice. Any question on the constitutionality or legality of a tax ordinance may be raised on appeal with the Secretary of Justice within 30 days from the effectivity thereof. ***(Sec. 187, LGC; Hagonoy Market Vendor Association v. Municipality of Hagonoy, 376 SCRA 376 [2002])***.

### Local Taxation: Legality; Imposition of Real Property Tax Rate (2002)

An Ordinance was passed by the Provincial Board of a Province in the North, increasing the rate of basic real property tax from 0.006% to 1 % of the assessed value of the real property effective January 1, 2000. Residents of the municipalities of the said province protested the Ordinance on the ground that no public hearing was conducted and, therefore, any increase in the rate of real property tax is void. Is there merit in the protest? Explain your answer. (2%)

**SUGGESTED ANSWER:**

The protest is devoid of merit. No public hearing is required before the enactment of a local tax ordinance levying the basic real property tax (Art. 324, LGC Regulations).

**ALTERNATIVE ANSWER:**

Yes, there is merit in the protest provided that sufficient proof could be introduced for the non-observance of public hearing. By implication, the Supreme Court recognized that public hearings are required to be conducted prior to the enactment of an ordinance imposing real property taxes. Although it was concluded by the highest tribunal that presumption of validity of a tax ordinance can not be overcome by bare assertions of procedural defects on its enactment, it would seem that if the taxpayer had presented evidence to support the allegation that no public hearing was conducted, the Court should have ruled that the tax ordinance is invalid. ***(Belen Figuerres v. Court of Appeals, GRNo. 119172, March 25, 1999)***.

### Local Taxation: Power to Impose (2003)

In order to raise revenue for the repair and maintenance of the newly constructed City Hall of Makati, the City Mayor ordered the collection of P1.00, called "elevator tax", every time a person rides any of the high-tech elevators in the city hall during the hours of 8:00 a.m. to 10:00 a.m. and 4:00 p.m. to 6:00 p.m. Is the "elevator tax" a valid imposition? Explain. (8%)

**SUGGESTED ANSWER:**

No. The imposition of a tax, fee or charge or the generation of revenue under the Local Government Code, shall be exercised by the SANGUNIAN of the local government unit concerned through an appropriate

ordinance *(Section 132 of the Local Government Code)*. The city mayor alone could not order the collection of the tax; as such, the "elevator tax" is an invalid imposition.

### Local Taxation: Remission/Condonation of Taxes (2004)

RC is a law-abiding citizen who pays his real estate taxes promptly. Due to a series of typhoons and adverse economic conditions, an ordinance is passed by MM City granting a 50% discount for payment of unpaid real estate taxes for the preceding year and the condonation of all penalties on fines resulting from the late payment. Arguing that the ordinance rewards delinquent taxpayers and discriminates against prompt ones, RC demands that he be refunded an amount equivalent to one-half of the real taxes he paid. The municipal attorney rendered an opinion that RC cannot be reimbursed because the ordinance did not provide for such reimbursement. RC files suit to declare the ordinance void on the ground that it is a class legislation. Will his suit prosper? Explain your answer briefly. (5%)

**SUGGESTED ANSWER:**

The suit will not prosper. The remission or condonation of taxes due and payable to the exclusion of taxes already collected does not constitute unfair discrimination. Each set of taxes is a class by itself and the law would be open to attack as class legislation only if all taxpayers belonging to one class were not treated alike ***(Juan Luna Subdivision, Inc., v. Sarmiento, 91 Phil. 371 [1952]).***

### Local Taxation: Rule of Uniformity and Equality (2003)

The City of Makati, in order to solve the traffic problem in its business districts, decided to impose a tax, to be paid by the driver, on all private cars entering the city during peak hours from 8:00 a.m. to 9:00 a.m. from Mondays to Fridays, but exempts those cars carrying more than two occupants, excluding the driver. Is the ordinance valid? Explain. (8%)

**SUGGESTED ANSWER:**

The ordinance is in violation of the Rule of Uniformity and Equality, which requires that all subjects or objects of taxation, similarly situated must be treated alike in equal footing and must not classify the subjects in an arbitrary manner. In the case at bar, the ordinance exempts cars carrying more than two occupants from coverage of the said ordinance. Furthermore, the ordinance only imposes the tax on private cars and exempts public vehicles from the imposition of the tax, although both contribute to the traffic problem. There exists no substantial standard used in the classification by the City of Makati.

Another issue is the fact that the tax is imposed on the driver of the vehicle and not on the registered owner of the same. The tax does not only violate the requirement of uniformity, but the same is also unjust because it places the burden on someone who has no control over the route of the vehicle. The ordinance is, therefore, invalid for violating the rule of uniformity and equality as well as for being unjust.

### Local Taxation; Situs of Professional Taxes (2005)

Mr. Fermin, a resident of Quezon City, is a Certified Public Accountant-Lawyer engaged in the practice of his two professions. He has his main office in Makati City and maintains a branch office in Pasig City. Mr. Fermin pays his professional tax as a CPA in Makati City and his professional tax as a lawyer in Pasig City. (5%)

a) May Makati City, where he has his main office, require him to pay his professional tax as a lawyer? Explain.

**SUGGESTED ANSWER:**

No. Makati City where Mr. Fermin has his main office may not require him to pay his professional tax as a lawyer. Mr. Fermin has the option of paying his professional tax as a lawyer in Pasig City where he practices law or in Makati City where he maintains his principal office. *(Sec. 139[b], Local Government Code)*

b) May Quezon City, where he has his residence and where he also practices his two professions, go after him for the payment of his professional tax as a CPA and a lawyer? Explain.

**SUGGESTED ANSWER:**

No, the situs of the professional tax is the city where the professional practices his profession or where he maintains his principal office in case he practices his profession in several places. The local government of Quezon City has no right to collect the professional tax from Mr. Fermin as the place of residence of the taxpayer is not the proper situs in the collection of the professional tax.

### Local Taxation; Special Levy on Idle Lands (2005)

A city outside of Metro Manila plans to enact an ordinance that will impose a special levy on idle lands located in residential subdivisions within its territorial jurisdiction in addition to the basic real property tax. If the lot owners of a subdivision located in the said city seek your legal advice on the matter, what would your advice be? Discuss. (5%)

**SUGGESTED ANSWER:**

I would advise the lot owners that a city, even if it is outside Metro Manila, may levy an annual tax on idle lands at the rate not exceeding five percent (5%) of the assessed value of the property which shall be in addition to the basic real property tax. *(Sec. 236, Local Government Code)* I would likewise advise them that the levy may apply to residential lots, regardless of land area, in subdivisions duly approved by proper authorities, the ownership of which has been transferred to individual owners who shall be liable for the additional tax. (Last par., Sec. 237)

The term "Idle Lands" means, land not devoted directly to any crop or to any definite purpose for at least one year prior to the notice of expropriation, except for reasons other than *force majeure* or any fortuitous event, but used to be devoted or is suitable to such crop or is contiguous to land devoted directly to any crop and does not include land devoted permanently or regularly to other essential and more productive purpose. *(Philippine Legal Encyclopedia, by Sibal, 1986 Ed.)*

Finally, I would advise them to construct or place improvements on their idle lands by making valuable additions to the property or ameliorations in the land's

conditions so the lands would not be considered as idle. (Sec. 199[m]) In this manner their properties would not be subject to the *ad valorem tax* on idle lands.

### Real Property Tax: Underground Gasoline Tanks (2003)

Under Article 415 of the Civil Code, in order for machinery and equipment to be considered real property, the pieces must be placed by the owner of the land and, in addition, must tend to directly meet the needs of the industry or works carried on by the owner. Oil companies install underground tanks in the gasoline stations located on land leased by the oil companies from the owners of the land where the gasoline stations [are] located. Are those underground tanks, which were not placed there by the owner of the land but which were instead placed there by the lessee of the land, considered real property for purposes of real property taxation under the local Government Code? Explain. (8%)

**SUGGESTED ANSWER:**

Yes. The properties are considered as necessary fixtures of the gasoline station, without which the gasoline station would be useless. Machinery and equipment installed by the

lessee of leased land is not real property for purposes of execution of a final judgment only. They are considered as real property for real property tax purposes as "other improvements to affixed or attached real property under the Assessment Law and the Real Property Tax Code. (***Caltex v. Central Board of Assessment Appeals, 114 SCRA 296 [1982]***).

### Real Property Tax; Requirements; Auction Sales of Property for Tax Delinquency (2006)

Quezon City published on January 30, 2006 a list of delinquent real property taxpayers in 2 newspapers of general circulation and posted this in the main lobby of the City Hall. The notice requires all owners of real properties in the list to pay the real property tax due within 30 days from the date of publication, otherwise the properties listed shall be sold at public auction.

Joachin is one of those named in the list. He purchased a real property in 1996 but failed to register the document of sale with the register of Deeds and secure a new real property tax declaration in his name. He alleged that the auction sale of his property is void for lack of due process considering that the City Treasurer did not send him personal notice. For his part, the City Treasurer maintains that the publication and posting of notice are sufficient compliance with the requirements of the law.

1. If you were the judge, how will you resolve this issue? (2.5%)

**SUGGESTED ANSWER:**

I will resolve the issue in favor of Joachin. In auction sales of property for tax delinquency, notice to delinquent landowners and to the public in general is an essential and indispensable requirement of law, the non-fulfillment of which vitiates the same ***(Tiongco v. Phil. Veterans Bank, G.R. No. 82782, Aug. 5, 1992).*** The failure to give notice to the right person i.e., the real owner, will render an auction sale void ***(Tan v. Bantegui, G.R. No, 154027, October 24, 2005; City Treasurer of Q.C. v. CA, G.R. No. 120974, Dec. 22, 1997).***

2. Assuming Joachin is a registered owner, will your answer be the same? (2.5%)

**SUGGESTED ANSWER:**

Yes. The law requires that a notice of the auction sale must be properly sent to Joachin and not merely through publication ***(Tan v. Bantegui, G.R. No, 154027, October 24,2005; Estate of Mercedes Jacob v. CA, G.R. No. 120435, Dec. 22, 1997).***

### Real Property Taxation: Capital Asset vs. Ordinary Asset (1995)

In 1990, Mr. Naval bought a lot for P1,000,000.00 In a subdivision with the intention of building his residence on it. In 1994, he abandoned his plan to build his residence on it because the surrounding area became a depressed area and land values in the subdivision went down; instead, he sold it for P800.000.00. At the time of the sale, the zonal value was P500.000.00.

1) Is the land a capital asset or an ordinary asset? Explain.
2) Is there any income tax due on the sale? Explain.

**SUGGESTED ANSWERS:**

1) The land is a capital asset because it is neither for sale in the ordinary course of business nor a property used in the trade or business of the taxpayer. (Sec. 33. NIRC).

2) Yes, Mr. Naval is liable to the 5% capital gains tax imposed under Section 21(e) of the Tax Code based on the gross selling price of P800.000.00 which is an amount higher than the zonal value.

### Real Property Taxation: Capital Gains vs. Ordinary Gains (1998)

What is the difference between capital gains and ordinary gains? [3%]

**SUGGESTED ANSWER:**

CAPITAL GAINS are gains realized from the sale or exchange of capital assets, while ORDINARY GAINS refer to gains realized from the sale or disposition of ordinary assets.

### Real Property Taxation: Coverage of Ordinary Income (1998)

What does the term "ordinary income" include? [2%]

**SUGGESTED ANSWER:**

The term ordinary income includes any gain from the sale or exchange of property which is not a capital asset. These are the gains derived from the sale or exchange of property such as stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the course of his trade or business, or property used in trade or business of a character which is subject to the allowance for depreciation, or real property used in trade or business of the taxpayer. *(Sec. 22 [Z] in relation to Sec. 39[A](1), both of the NIRC).*

**ALTERNATIVE ANSWER:**

The term ordinary income includes income from performance of services, whether professional or personal, gains accruing from business, and profit arising from the sale or exchange of ordinary assets.

### Real Property Taxation: Exchange of Lot; Capital Gain Tax (1997)

A corporation, engaged in real estate' development, executed deeds of sale on various subdivided lots. One buyer, after going around the subdivision, bought a corner lot with a good view of the surrounding terrain. He paid P1.2 million, and the title to the property was issued. A year later, the value of the lot appreciated to a market value of P1.6 million, and the buyer decided to build his house thereon. Upon inspection, however, he discovered that a huge tower antennae had been erected on the lot frontage totally blocking his view. When he complained, the realty company exchanged his lot with another corner lot with an equal area but affording a better view. Is the buyer liable for capital gains tax on the exchange of the lots?

**SUGGESTED ANSWER:**

Yes, the buyer is subject to capital gains tax on the exchange of lots on the basis of prevailing fair market value of the property transferred at the time of the exchange or the fair market value of the property received, whichever is higher *(Section 21(e), NIRC).* Real property transactions subject to capital gains tax are not limited to sales but also exchanges of property unless exempted by a specific provision of law.

**ALTERNATIVE ANSWER:**

No. The exchange is not subject to capital gains tax because it is merely done to comply with the intentions of the parties to the previous contract regarding the sale and acquisition of a property with a good view. This is a simple substitution of the object of sale and since the previous transaction was already subjected to tax, no new tax should be imposed on the exchange *(BIR Ruling No. 21(e) 053-89 008-95).*

### Real Property Taxation: Exemption/Deductions; Donor's Tax (1998)

Ace Tobacco Corporation bought a parcel of land situated at Pateros and donated it to the Municipal Government of Pateros for the sole purpose of devoting the said land as a relocation site for the less fortunate constituents of said municipality. In accordance therewith, the Municipal Government of Pateros issued to the occupants/beneficiaries Certificates of Award giving to them the respective areas where their houses are erected. Through Ordinance No. 2, Series of 1998, the said municipal government ordained that the lots awarded to the awardees/donees be finally transferred and donated to them. Determine the tax consequence of the foregoing dispositions with respect to Ace Tobacco Corporation, the Municipal Government of Pateros, and the occupants/beneficiaries. [5%]

**SUGGESTED ANSWER:**

The donation by Ace Tobacco Corporation is ***exempt from the donor's tax*** because it qualifies as a gift to or for the use of any political subdivision of the National Government (Section 101(2), NIRC). The conveyance is likewise exempt from documentary stamp tax because it is a transfer without consideration.

Since the donation is to be used as a relocation site for the less fortunate constituents of the municipality. It may be considered as an undertaking for human settlements, hence the value of the land ***may be deductible in full from the gross income*** of Ace Tobacco Corporation if in accordance to a National Priority Plan determined by the National Economic Development Authority. *(Sec. 34{H](2)(a), NIRC).* If the utilization is not in accordance to a National Priority Plan determined by the National Economic Development Authority, then Ace Tobacco Corporation may deduct the value of the land donated only to the extent of five (5%) percent of its taxable income derived from trade or business as computed without the benefit of the donation. *(Sec. 34[H](2)(a) in relation to Sec. 34[H](1), NIRC).*

The Municipality of Pateros is not subject to any donor's tax on the value of land it subsequently donated, it being exempt from taxes as a political subdivision of the National Government.

The occupants/beneficiaries are subject to real property taxes because they now own the land.

**ALTERNATIVE ANSWER** *on Taxability of Municipality and Awardees:*

The awarding by the Municipal Government of lots to specific awardees or donees is likewise exempt from the donor's tax because it is only an implementation of the purpose for which the property was given by Ace Tobacco Corporation. The purpose of the first donation is to devote the land as a relocation site for the less fortunate constituents. If later on the Municipality gives out Certificates of Award over specific lots occupied by the qualified occupants/beneficiaries, this is intended to perpetuate the purpose of the previous donor, the Municipality acting merely as a conduit and not the true donor. This is simply a donation by the Municipality in form but not in substance.

The receipt by the occupant beneficiaries of their respective lots through the Certificate of Award has no tax implications. They are, however, liable for real property taxes.

### Real Property Taxation: Exemption: Acquiring New Principal Residence (2000)

Last July 12, 2000, Mr. & Mrs. Peter Camacho sold their principal residence situated in Tandang Sora, Quezon City for Ten Million Pesos (P10,000,000.00) with the intention of using the proceeds to acquire or construct a new principal residence in Aurora Hills, Baguio City. What conditions must be met in order that the capital gains presumed to have been realized from such sale may not be subject to capital gains tax? (5%)

**SUGGESTED ANSWER:**

The conditions are:

1. The proceeds are fully utilized in acquiring or constructing a new principal residence within eighteen (18) calendar months from the sale or disposition of the principal residence or eighteen (18) months from July 12, 2000.

2. The historical cost or adjusted basis of the real property sold or disposed shall be carried over to the new principal residence built or acquired.

3. The Commissioner of Internal Revenue must have been informed by Mr. & Mrs. Peter Camacho within thirty (30) days from the date of sale or disposition on July 12, 2000 through a prescribed return of their intention to avail of the tax exemption.

4. That the said exemption can only be availed of once every ten (10) years.

5. If there is no full utilization of the proceeds of sale or disposition, the portion of the gain presumed to have been realized from the sale or disposition shall be subject to capital gains tax *[Sec. 24 (D) (2), NIRC of 1997]*

### Real Property Taxation: Fundamental Principles (1997)

State the fundamental principles underlying real property taxation in the Philippines.

**SUGGESTED ANSWER:**

The following are the fundamental principles governing real property taxation:

1) Real property shall be appraised at its current and fair market value;
2) Real property shall be classified for assessment purposes on the basis of its actual use:
3) Real property shall be assessed on the basis of a uniform classification within each local government unit;
4) The appraisal, assessment, levy, and collection of real property tax shall not be let to any private person; and
5) The appraisal and assessment of real property shall be equitable.

### Real Property Taxation: Principles & Limitations: LGU (2000)

Give at least two (2) fundamental principles governing real property taxation, which are limitations on the taxing power of local governments insofar as the levying of the realty tax is concerned. (2%)

**SUGGESTED ANSWER:**

Two (2) fundamental principles governing real property taxation are:

1) The appraisal must be at the current and fair market value; and
2) Classification for assessment must be on the basis of actual use. *(Sec. 198, Local Government Code)*

**ALTERNATIVE ANSWER:**

The examinee should be given credit if he chooses the above two (2) or any two (2) of those enumerated below:

1) Assessment must be on the basis of uniform classification;

2) Appraisal, assessment, levy and collection shall not be let to private persons; and

3) Appraisal and assessment must be equitable. *(Sec. 198, Local Government Code)*

### Real Property Taxation: Property Sold is an Ordinary Asset (1998)

An individual taxpayer who owns a ten (10) door apartment with a monthly rental of P10,000 each residential unit, sold this property to another individual taxpayer. Is the seller liable to pay the capital gains tax? [5%]

**SUGGESTED ANSWER:**

No. The seller is not liable to pay the capital gains tax because the property sold is an ordinary asset, i.e. real property used in trade or business. It is apparent that the taxpayer is engaged in the real estate business, regularly renting out the ten (10) door apartment.

### Real Property Taxation: Underground Gasoline Tanks (2001)

Under Article 415 of the Civil Code, in order for machinery and equipment to be considered real property, they must be placed by the owner of the land and, in addition, must tend to directly meet the needs of the industry or works carried on by the owner. Oil companies, such as Caltex and Shell, install underground tanks in the gasoline stations located on land leased by the oil companies from others. Are those underground tanks which were not placed there by the owner of the land but which were instead placed there by the lessee of the land, considered real property for purposes of real property taxation under the Local Government Code? Explain your answer. (5%)

**SUGGESTED ANSWER:**

Yes. The underground tanks although installed by the lessee, Shell and Caltex, are considered as real property for purposes of the imposition of real property taxes. It is only for purposes of executing a final judgment that these machinery and equipment, installed by the lessee on a leased land, would not be considered as real property. But in the imposition of the real property tax, the underground tanks are taxable as necessary fixtures of the gasoline station without which the gasoline station would not be operational. (***Caltex Phils., Inc v. CBAA, 114 SCRA. 296***).

### Real Property Taxation; Exempted Properties (2006)

What properties are exempt from the real property tax? (5%)

**SUGGESTED ANSWER:**

The following properties are exempt from the real property tax (Section 234, Local Government Code):

(1) Real property owned by the REPUBLIC OF THE PHILIPPINES or any of its political subdivisions except when the beneficial use thereof has been granted for consideration or otherwise to a taxable person;
(2) CHARITABLE INSTITUTIONS, churches, parsonages or convents appurtenant thereto, mosques, non-profit or religious cemeteries, and all lands, buildings, and improvements actually, directly and exclusively used for religious, charitable or educational purposes;
(3) All machineries and equipment that are actually, directly and exclusively used by LOCAL WATER UTILITIES and government-owned or controlled corporations engaged in the supply and distribution

of water and/or generation and transmission of electric power;

(4) All real property owned by duly REGISTERED COOPERATIVES as provided for under R.A. 6938; and

*(5)* Machinery and equipment used for *POLLUTION CONTROL* and *ENVIRONMENTAL PROTECTION*.

# TARIFF AND CUSTOMS DUTIES

### Customs: "Flexible Tariff Clause" (2001)

What do you understand by the term "flexible tariff clause" as used in the Tariff and Customs Code? (5%)

**SUGGESTED ANSWER:**

The term "***flexible tariff clause*** "refers to the authority given to the President to adjust tariff rates under Section 401 of the Tariff and Customs Code, which is the enabling law that made effective the delegation of the taxing power to the President under the Constitution.

[**Note**: *It is suggested that if the examinee cites the entire provision of Sec. 401 of the Tariff &, Customs Code, he should also be given full credit.*]

### Customs: Administrative vs. Judicial Remedies (1997)

The Tariff and Customs Code allows the Bureau of Customs to resort to the administrative remedy of seizure, such as by enforcing the tax lien on the imported article, and to the judicial remedy of filing an action in court. When does the Bureau of Customs normally avail itself;

(a) of the administrative, instead of the judicial remedy, or

(b) of the latter, instead of the former, remedy?

**SUGGESTED ANSWER:**

(a) The Bureau of Customs normally avails itself of the ADMINISTRATIVE REMEDY of seizure, such as by enforcing the tax lien on the imported articles, instead of the judicial remedy when the goods to which the tax lien attaches, regardless of ownership, is still in the custody or control of the Government. In the case, however, of importations which are prohibited or undeclared, the remedy of seizure and forfeiture may still be exercised by the Bureau of Customs even if the goods are no longer in its custody.

(b) On the other hand, when the goods are properly released and thus beyond the reach of tax lien, the government can seek payment of the tax liability through judicial action since the tax liability of the importer constitutes a personal debt to the government, therefore, enforceable by action. In this case judicial remedy is normally availed of instead of the administrative remedy.

### Customs: Importation (1995)

When does importation begin and when does it end?

**SUGGESTED ANSWER:**

IMPORTATION begins from the time the carrying vessel or aircraft enters Philippine territorial jurisdiction with the intention to unload therein and ends at the time the goods are released or withdrawn from the customhouse upon payment of the customs duties or with legal permit to withdraw (***Viduya vs. Berdiago, 73 SCRA 553***).

### Customs: Jurisdiction; Seizure & Forfeiture Proceedings (1996)

On January 1, 1996, armed with warrants of seizure and detention issued by the Bureau of Customs, members of the customs enforcement and security services coordinated with the Quezon City police to search the premises owned by a certain Mr. Ho along Kalayaan Avenue, Quezon City, which allegedly contained untaxed vehicles and parts. While inside the premises, the member of the customs enforcement and security services noted articles which were not included in the list contained in the warrant. Hence, on January 15, 1996, an amended warrant and seizure was issued.

On January 25, 1996, the customs personnel started hauling the articles pursuant to the amended warrant. This prompted Mr. Ho to file a case for injunction and damages with a prayer for a restraining order before the Regional Trial Court of Quezon City against the Bureau of Customs on January 27, 1996. On the same date, the Trial Court issued a temporary restraining order.

A motion to dismiss was filed by the Bureau of Customs on the ground that the Regional Trial Court has no jurisdiction over the subject matter of the complaint claiming that it was the Bureau of Customs that has exclusive jurisdiction over it. Decide.

**SUGGESTED ANSWER:**

The motion to dismiss should be granted. Seizure and forfeiture proceedings are within the exclusive jurisdiction of the Collector of Customs to the exclusion of regular Courts. Regional Trial Courts are devoid of competence to pass upon the validity or regularity of seizure and forfeiture proceedings conducted by the Bureau of Customs and to enjoin or otherwise interfere with these proceedings (***Republic vs. CFI of Manila [Branch XXII], G.R. No. 43747, September 2, 1992; Jao vs. CA, G.R. No. 104604, October 6, 1995***).

### Customs: Kinds of Custom Duties (1995)

Under the Tariff and Customs Code, what are

a) dumping duties
b) countervailing duties
c) marking duties
d) discriminatory duties?

**SUGGESTED ANSWER:**

6) ***Dumping duties*** are special duties imposed by the Secretary of Finance upon recommendation of the Tariff Commission when it is found that the price of the imported articles is deliberately or continually fixed at less than the fair market value or cost of production, and the importation would cause or likely cause an injury to local industries engaged in the manufacture or production of the same or similar articles or prevent their establishment.

7) ***Countervailing duties*** are special duties imposed by the Secretary of Finance upon prior investigation and report of the Tariff Commission to offset an excise or inland revenue tax upon articles of the same class manufactured at home or subsidies to foreign producers or manufacturers by their respective governments.

8) ***Marking duties*** are special duties equivalent to 5% ad valorem imposed on articles not properly marked. These are collected by the Commissioner of Customs except when the improperly marked articles are exported or destroyed under customs supervision and prior to final liquidation of the corresponding entry. These duties are designed to prevent possible deception of the customers.

9) ***Discriminatory duties*** are special duties collected in an amount not exceeding 100% ad valorem, imposed by the President of the Philippines against goods of a foreign country which discriminates against Philippine commerce or against goods coming from the Philippines and shipped to a foreign country.

### Customs: Kinds of Custom Duties (1997)

Explain briefly each of the special customs duties authorized under the Tariff and Customs Code.

**SUGGESTED ANSWER:**

The following are the ***Special Duties*** imposed under the Tariff and Customs Code:

(a) ***Dumping Duty*** - This is a duty levied on imported goods where it appears that a specific kind or class of foreign article is being imported into or sold or is likely to be sold in the Philippines at a price less than its fair value;

(b) ***Countervailing Duty*** - This is a duty equal to the ascertained or estimated amount of the subsidy or bounty or subvention granted by the foreign country on the production, manufacture, or exportation into the Philippines of any article likely to injure an industry in the Philippines or retard or considerable retard the establishment of such industry;

(c) ***Marking Duty*** - This is a duty on an ad valorem basis imposed for improperly marked articles. The law requires that foreign importations must be marked in any official language of the Philippines the name of the country of origin of the article;

(d) ***Discriminatory or Retaliatory Duty*** - This is a duty imposed on imported goods whenever it is found as a fact that the country of origin discriminates against the commerce of the Philippines in such a manner as to place the commerce of the Philippines at a disadvantage compared with the commerce of any foreign country.

### Customs: Remedies of an Importer (1996)

Discuss briefly the remedies of an importer during the pendency of seizure proceedings.

**SUGGESTED ANSWER:**

During the pendency of seizure proceedings the importer may secure the release of the imported property for legitimate use by posting a bond in an amount to be fixed by the Collector, conditioned for the payment of the appraised value of the article and/or any fine, expenses and costs which may be adjudged in the case; *provided, that articles the importation of which is prohibited by law shall not be released under bond.*

The importer may also offer to pay to the collector a fine imposed by him upon the property to secure its release or in case of forfeiture, the importer shall offer to pay for the domestic market value of the seized article, which offer subject to the approval of the Commissioner may be accepted by the Collector in settlement of the seizure case, except when there is fraud. Upon payment of the fine or domestic market value, the property shall be forthwith released and all liabilities which may or might attach to the property by virtue of the offense which was the occasion of the seizure and all liability which might have been incurred under any bond given by the importer in respect to such property shall thereupon be deemed to be discharged.

### Customs: Returning Residents: Tourist/Travelers (2003)

X and his wife, Y, Filipinos living in the Philippines, went on a three-month pleasure trip around the world during the months of June, July and August 2002. In the course of their trip, they accumulated some personal effects which were necessary, appropriate and normally used in leisure trips, as well as souvenirs in non-commercial quantities. Are they "returning residents" for purposes of Section 105 of the Tariff and Customs Code? Explain. (8%)

**SUGGESTED ANSWER:**

No. The term "returning residents" refers to nationals who have stayed in a foreign country for a period of at least six (6) months. *(Section 105(f) of the Tariff and Customs Code).* Due to their limited duration of stay abroad X and Y are not considered as "returning residents" but they are merely considered as travelers or tourists who enjoy the benefit of conditionally free importation.

*[Note: Credit must likewise be given if the candidate answered in the affirmative, considering that travelers or tourists are given the same tax treatment as that of returning residents, treating their personal effects, not in commercial quantities, as conditionally free importation.]*

### Customs: Seizure & Forfeiture: Effects (1994)

In smuggling a shipment of garlic, the smugglers used an eight-wheeler truck which they hired for the purpose of taking out the shipment from the customs zone. Danny, the truck owner, did not have a certificate of public convenience to operate his trucking business. Danny did not know that the shipment of garlic was illegally imported.

Can the Collector of Customs of the port seize and forfeit the truck as an instrument in the smuggling?

**SUGGESTED ANSWER:**

Yes, the Collector of Customs of the port can seize and forfeit the truck as an instrument in the smuggling activity, since the same was used unlawfully in the importation of

smuggled articles. The mere carrying of such articles on board the truck (in commercial quantities) shall subject the truck to forfeiture, since it was not being used as a duly authorized common carrier, which was chartered or leased as such. (Sec. 2530 [a], TCC)

Moreover, although forfeiture of the vehicle will not be effected if it is established that the owner thereof had no knowledge of or participation in the unlawful act, there arises a *prima facie* presumption or knowledge or participation if the owner is not in the business for which the conveyance is generally used. Thus, not having a certificate of public convenience to operate a trucking business, he is legally deemed not to have been engaged in the trucking business. *(Sec. 2531, Tariff and Customs Code)*

### Customs: Steps involving Protest Cases (1994)

The Collector of Customs instituted seizure proceedings against a shipment of motor vehicles for having been misdeclared as second-hand vehicles. State the procedure for the review of the decision up to the Supreme Court of the Collector of Customs adverse to the importer.

**SUGGESTED ANSWER:**

The procedure in seizure cases may be summarized as follows:

(a) The collector issues a warrant for the detention or forfeiture of the imported articles; (Sec. 2301, Tariff and Customs Code)
(b) The Collector gives the importer a written notice of the seizure and fixes a hearing date to give the importer an opportunity to be heard; (Sec. 2303, TCC)
(c) A formal hearing is conducted; (Sec. 2312, TCC)
(d) The Collector renders a declaration of forfeiture; (Sec. 2312, TCC)
(e) The Importer aggrieved by the action of the Collector in any case of seizure may appeal to the Commissioner for his review within fifteen (15) days from written notice of the Collector's decision; (Sec. 2313, TCC)
(f) The importer aggrieved by the action or ruling of the Commissioner in any case of seizure may appeal to the Court of Tax Appeals; (Sec. 2402, TCC)
(g) The importer adversely affected by the decision of the Court of Tax Appeals (Division) may appeal to the Court of Tax Appeals (en banc) within fifteen (15) days which may be extended for another fifteen (15) days or such period as the Court of Tax Appeals may decide.

### Customs; Basis of Dutiable Value; Imported Article (2005)

State and explain the basis of dutiable value of an imported article subject to an ad valorem tax under the Tariff and Customs Code.

**ALTERNATIVE ANSWER:**

The basis of dutiable value of an imported article subject to an *ad valorem tax* under the Tariff and Customs Code is its TRANSACTION VALUE. (*Sec. 201[A], Tariff and Customs Code, as amended by R.A. No. 9135)* If such value could not be determined, then the following values are to be utilized in their sequence: ***Transaction value of identical goods*** *(Sec. 201[B]);* ***Transaction value of similar goods*** *(Sec. 201[C]);* ***Deductive value*** *(Sec. II.E.1, CA.O. No. 4-2004);* ***Computed value*** (*Sec., II.F.l, C.A.O. No. 1-20040*) and ***Fallback value***. (*Sec. 201[F]*)

**ALTERNATIVE ANSWER:**

The basis of dutiable value of an imported article subject to an ad valorem tax under the Tariff and Customs Code is its transaction value, which shall be the price actually paid or payable for the goods when sold for export to the Philippines, adjusted by adding certain cost elements to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the imported goods. *(Sec. 201[A], Tariff and Customs Code, as amended by R.A. 9135)*

If such value could not be determined, then the following values are to be utilized in their sequence: Transaction value of identical goods (Sec. 201[B]); Transaction value of similar goods (Sec. 201[C]); Deductive value (Sec. II.E.1, CA.O. No. 4-2004); Computed value (Sec. II.F.l, C.A.O. No. 1-20040) and Fallback value. (Sec. 201[F])

### Customs; Countervailing Duty vs. Dumping Duty (2005)

Distinguish countervailing duty from dumping duty. (5%)

**SUGGESTED ANSWER:**

The distinctions between countervailing duty and dumping duty are the following:

(1) Basis: The countervailing duty is imposed whenever there is granted upon the imported article by the country of origin a specific subsidy upon its production, manufacture or exportation and this results or threatens injury to local industry while the basis for the imposition of dumping duty is the importation and sale of imported items at below their normal value causing or likely to cause injury to local industry.

(2) Amount: The countervailing duty imposed is equivalent to the value of the specific subsidy while the dumping duty is equivalent to the margin of dumping which is equal to the difference between the export price to the Philippines and the normal value of the imported article.

### Customs; Taxability; Personal Effects (2005)

Jacob, after serving a 5-year tour of duty as military attache in Jakarta, returned to the Philippines bringing with him his personal effects including a personal computer and a car. Would Jacob be liable for taxes on these items? Discuss fully. (5%)

**SUGGESTED ANSWER:**

No, Jacob is not liable for taxes on his personal computer and the car because he is tax-exempt by law. He has met the following requirements for exemption under P.D. No. 922 (1976):

a) He was a military attache assigned to Jakarta;
b) He has served abroad for not less than two (2) years;
c) He is returning to the Philippines after serving his tour of duty; and
d) He has not availed of the tax exemption for the past four (4) years.

He is entitled to tax exemption on his personal and household effects including a car; provided,

a) The car must have been ordered or purchased prior to the receipt by the Philippine mission or consulate in Jakarta of Jacob's recall order;
b) the car is registered in Jacob's name;
c) the exemption shall apply to the value of the car;
d) the exemption shall apply to the aggregate value of his personal and household effects (including the personal computer) not exceeding thirty per centum (30%) of the total amount received by Jacob as salary and allowances during his assignment in Jakarta, but not to exceed four (4) years;
e) Jacob must not have availed of the exemption more oftener than one every four years. (*Last par., Sec. 105, Tariff and Customs Code*)

# OTHER RELATED MATTERS

### BIR: Bank Deposits Secrecy Violation (2000)

A taxpayer is suspected not to have declared his correct gross income in his return filed for 1997. The examiner requested the Commissioner to authorize him to inquire into the bank deposits of the taxpayer so that he could proceed with the net worth method of investigation to establish fraud. May the examiner be allowed to look into the taxpayer's bank deposits? In what cases may the Commissioner or his duly authorized representative be allowed to inquire or look into the bank deposits of a taxpayer? (5%)

**SUGGESTED ANSWER:**

No. as this would be violative of Republic Act No. 1405, the Bank Deposits Secrecy Law.

The Commissioner of Internal Revenue or his duly authorized representative may be allowed to inquire or look into the bank deposits of a taxpayer in the following cases:

a) For the purpose of determining the gross estate of a decedent;
b) Where the taxpayer has filed an application for compromise of his tax liability by reason of financial incapacity to pay such tax liability. (Sec. 6 (F), NIRC of 1997]
c) Where the taxpayer has signed a waiver authorizing the Commissioner or his duly authorized representatives to Inquire into the bank deposits.

### BIR: Secrecy of Bank Deposit Law (2003)

X dies in year 2000 leaving a bank deposit of P2,000,000.00 under joint account with his associates in a law office. Learning of X's death from the newspapers, the Commissioner of Internal Revenue wrote to every bank in the country asking them to disclose to him the amount of deposits that might be outstanding in his name or jointly with others at the date of his death. May the bank holding the deposit refuse to comply on the ground of the Secrecy of Bank Deposit Law? Explain. (8%)

**SUGGESTED ANSWER:**

No. The Commissioner of Internal Revenue has the authority to inquire into bank deposit accounts of a decedent to determine his gross estate notwithstanding the provisions of the Bank Secrecy Law. Hence, the banks holding the deposits in question may not refuse to disclose the amount of deposits on the ground of secrecy of bank deposits. (Section 6(F) of the 1997 Tax Code). The fact that the deposit is a joint account will not preclude the Commissioner from inquiring thereon because the law mandates that if a bank has knowledge of the death of a person, who maintained a bank deposit account alone, or jointly with another, it shall not allow any withdrawal from the said deposit account, unless the Commissioner has certified that the taxes imposed thereon have been paid. (Section 97 of the 1997 Tax Code). Hence, to be able to give the required certification, the inclusion of the deposit is imperative, which may be made possible only through the inquiry made by the Commissioner.